

Environment, Planning and Sustainable Development Directorate

To: Treasurer
Minister for Water, Energy and Emissions Reduction

Tracking No.: CMTEDD2023/3538
EPSDD2023/84129

Date: 23/08/2023

From: Deputy Director-General, Environment, Water and Emissions Reduction (EPSDD)
A/g Executive Group Manager, Economic and Financial Group (CMTEDD)

Subject: Review of the water abstraction charge

Critical Date: As soon as possible

Critical Reason: To enable the review to commence in a timely manner.

- UT 23/08/23
- DUT 18/08/23

Recommendations

That you:

1. **Note** that the Environment Planning and Sustainable Development Directorate (EPSDD) has received consultant advice that queries whether the ACT is meeting its obligations under the Commonwealth Water Charge Rules (WCR), through charging more than the ACT's cost for water through the Water Abstraction Charge.

Noted / Please Discuss
Andrew Barr MLA

Noted / Please Discuss
Shane Rattenbury MLA

2. **Note** the ACT has agreed to the WCR, which set-out objectives and principles for the pricing of regulatory water charges, which are based on full cost recovery.

Noted / Please Discuss
Andrew Barr MLA

Noted / Please Discuss
Shane Rattenbury MLA

3. **Agree** to review the methodology for setting water charges to ensure compliance with the WCR and to ensure the charge remains consistent with its purpose.

Agree / Not Agreed / Please Discuss
Andrew Barr MLA

Agree / Not Agreed / Please Discuss
Shane Rattenbury MLA

4. **Agree** that a price investigation notice be issued to the Independent Competition and Regulatory Commission (ICRC) to conduct the review in accordance with section 12 of the Independent Competition and Regulatory Commission Act 1997.

Agree / Not Agreed / Please Discuss
Andrew Barr MLA

Agree / Not Agreed / Please Discuss
Shane Rattenbury MLA

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5. **Note** that the scope of work to inform the price investigation notice will be provided for Treasurer and Minister for Water, Energy and Emissions Reduction approval.

Agree / Not Agreed / Please Discuss
Andrew Barr MLA

Agree / Not Agreed / Please Discuss
Shane Rattenbury MLA

6. **Note** that you will be kept updated on the progress of the review, including the intention of CMTEDD and EPSDD to prepare a joint Cabinet Submission on the outcomes.

Noted / Please Discuss
Andrew Barr MLA

Noted / Please Discuss
Shane Rattenbury MLA

Andrew Barr MLA.....  3./9./23

Minister's Office Feedback

Shane Rattenbury MLA..... /...../.....

Minister's Office Feedback

Background

1. In August 2022, Cabinet agreed (22/159) to a program of priority reform activities for the management of the ACT's water. This included an action to improve accountability and transparency for current funding arrangements. This action predominately relates to the Water Abstraction Charge (WAC), a regulatory water charge for potable and non-potable water levied by the ACT Government.
2. The WAC is intended to recover catchment management costs, to reflect the environmental costs from water abstraction and the value of the water as a natural resource (scarcity value).
3. The WAC is separately determined for two categories of water use under the *Water Resources (Fees) Determination 2022 (No 2)*, being:
 - a. urban water supply (i.e. potable water use) - \$0.67 per kilolitre in 2022-23; and
 - b. surface water or groundwater (i.e. non-potable water use) - \$0.324 per kilolitre in 2022-23.
4. The Minister for Water determines water fees and charges under s110 of the *Water Resources Act 2007*.
5. The Treasurer has responsibility for competition policy and through this, the capacity to issue price directions to the Independent Competition and Regulatory Commission (ICRC) in relation to the prices charged through monopoly infrastructure providers, such as Icon Water. However, the ICRC has no legislative responsibilities for setting or regulating the WAC.

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- a. The Treasurer previously issued directions under the *Independent Competition and Regulatory Commission Act 1997* to the ICRC to establish the methodology for determination of the WAC, the appropriate level for the charge, and how it is charged to customers. The 2003 ICRC's advice led to the basis for the WAC that is used today.
 - b. For potable water use, the WAC is collected from consumers on behalf of the Government by Icon Water indirectly through water prices. For non-potable water use, the WAC is paid directly by licence holders to the ACT Government, through invoicing managed by Access Canberra's, Environmental Protection Authority (EPA).
6. The ACT's method for calculating water charges has not been updated since the ICRC's 2003 review to reflect subsequent policy and legislative instruments, including the *Water Act 2007 (Cwlth)*, 2010 National Water Initiative (NWI) Pricing Principles and the Commonwealth Water Charge Rules (WCRs).
7. There has been ongoing scrutiny of the WAC; most recently in the *State of the Lake and Waterways Report (2022)*, which was prepared by the Office for the Commissioner for Sustainability and the Environment (the Commissioner). The Commissioner recommended that the ACT Government publish an annual detailed breakdown of how the WAC revenue is expended. The Government's response (22/442) agreed in-principle to this recommendation.
8. In 2022, EPSDD (Office of Water) contracted Slattery and Johnson to review the appropriateness of the current WAC reporting and provide advice on potential improvements. The report is provided at Attachment A.

Issues

9. Slattery and Johnson advise a range of issues relating to the WAC that may expose the ACT Government to financial, operational and compliance risk.
10. These issues stem from:
- a. the *Water Act 2007 (Cwlth)*, NWI and WCRs requiring the ACT's WAC to be based on recovery of costs only;
 - b. over-recovery of costs because of increases to the WAC that are not aligned with the ICRC's original methodology, such as the decision of the ACT Government to apply a 3 per cent annual indexation to the WAC for potable and non-potable water rather than looking to ensure cost recovery only;
 - c. the ACT including the market price of water as a factor in the level of the WAC;
 - d. a lack of transparency in how the WAC is set each year; and
 - e. a misalignment between the components of the WAC and ACCC reporting requirements.

National Water Initiative (NWI) and Water Charge Rules (WCRs)

11. Australian governments agreed through the Intergovernmental Agreement on a NWI (2004) to implement water pricing and institutional arrangements that promote economically efficient and sustainable use of water resources, provide revenue stream

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for efficient delivery of services, give effect to the principles of user pays where feasible and practical, and avoid perverse or unintended pricing outcomes.

12. The outcomes and actions of the NWI are given effect through:

- a. Murray Darling Basin Water Pricing Objectives and Principles (*Water Act 2007*)
- b. NWI Pricing Principles (2010),
- c. WCRs (2010) - made under the *Water Act 2007*.

13. The WCRs are based on full cost recovery including water planning and management costs, environmental externalities and capital costs. However, in addition to the components of the WCRs, the WAC also factors in, through the scarcity component, the market value of water as an additional mechanism to capture environmental externalities. Scarcity value was considered by the national governments through the national water pricing reforms as an alternative pricing approach to environmental externality, however, it was not adopted as it was considered that there were better mechanisms to achieve the policy objective.

14. Given that the WAC methodology developed by the ICRC in 2003 pre-dates multiple outcomes and actions of the *Water Act 2007 (Cwlth)* and NWI, it is unclear if the current methodology ensures water charges are consistent with these obligations.

Transparency in WAC determination

15. The WCRs state that urban water tariffs should be set using a transparent methodology through a process that considers public comment, or which is the subject of public scrutiny and use independent bodies to set or review prices or price setting processes.

16. The WAC is overdue for review, most recently examined by the ICRC through the Treasurer's 2003 price inquiry. Further, price increases in 2006-07 and 2014-15 were approximately 146 per cent and 3 per cent above WPI respectively.

17. We note the 2006-07 Budget Papers advised the WAC was increasing to '*better reflect the value of water*', provide '*the Government with a return on a valuable resource*' and to '*assist in managing demand for water*'.

- a. It is unclear if the 2014-15 increase in the rate of the WAC had regard to WCRs obligations.
- b. It is also unclear whether the ACT Government's decision, in the 2016-17 Budget Review, to apply an ongoing 3 per cent annual indexation to the WAC for both potable and non-potable water use from 2017-18 onwards, had regard to WCRs obligations.

18. Slattery and Johnson suggest that:

- a. an independent body should have responsibility for routinely reviewing water charge methodology; and

- b. there needs to be greater transparency around the application of the WAC, given there is little public information available on the how the WAC is determined each year or expenditure reconciled.

Transparency in reporting

19. The Australian Competition and Consumer Commission (ACCC) has legislative responsibility for annually monitoring regulated water charges and their compliance with WCRs. The ACT provides the ACCC with an annual statement on the fees charged for water in the ACT, the extent of any change fees and the reason for any change, and the revenue from each charge. Further, the ACT is required to provide a breakdown of the capital, operating and corporate costs to manage water and planning activities to the ACCC.
20. The ACT's reporting on water charges (revenue and expenditure) is unable to be reconciled due to a misalignment between the methodology for the WAC and WCRs and the ACCC's reporting requirements. Improved reporting on the water charge methodology will be a key consideration in any work undertaken by the ACT.

Over-recovery against costs

21. Currently, revenue from the WAC forms part of the ACT Government's consolidated revenue and is not hypothecated. Expenditure of consolidated revenue is set out in the ACT Budget, which includes spending on water initiatives. There is no public reporting on the costs incurred against the WAC, and consequently no transparency around whether the WAC is set at a rate that allows for cost recovery and no more.
22. The ACCC Water Monitoring Report (2020-21) presents that the ACT has the highest cost recovery rate (percent of costs incurred compared to costs recovered) across the Basin States (Attachment B, Figure 1). For example, revenue levied through the WAC has significantly exceeded costs reported for water planning and management activities since 2015-16 (except for 2019-20). Accordingly, in 2021-22, the WAC raised \$29 million in revenue which was significantly greater than the costs reported for water planning and management at approximately \$11 million.
23. Slattery and Johnson found that applying the methodology developed by the ICRC does not support the price trend or absolute value of the WAC increases from 2003-04 to 2022-23 (Attachment B, Figure 2).
24. This is largely attributable to:
 - a. Water supply and environmental cost components of the charge appear to have been increased incrementally each year roughly in line with inflation.
 - b. The scarcity value component of the WAC, which appears to have increased significantly from 4.4 cents/kilolitre in 2003-04 to 45.9 cents/kilolitre in 2022-23.
25. The NWI Pricing Principles address over-recovery of costs: *'where usage charges lead to revenue recovery in excess of upper bound revenue requirements...jurisdictions are to address the over recovery. In addressing the over recovery, revenues should be redistributed to customers as soon as possible'*.

Proposed pathway forward

26. Slattery and Johnson's primary recommendations concentrated on the need for an independent annual review of the WAC and improved public transparency. Both were also recommended by the ICRC in their recommendations to the Treasurer on setting the framework for the WAC in 2003.
27. Given the issues outlined, it is proposed that the Government move towards ensuring that the methodology for setting a water charge is consistent with the ACT's obligations under the WCRs, allows reporting that could be subject to public scrutiny and establishes a periodic review process to ensure the charge remains consistent with its purpose.
28. EPSDD and CMTEDD recommend that the Treasurer seek advice from the ICRC to allow the ACT Government to decide on how to best meet its obligations, and, accordingly, that a price investigation notice be issued to ICRC to conduct the review in accordance with section 12 of the *Independent Competition and Regulatory Commission Act 1997* to this effect.
29. To support this request for advice, EPSDD and CMTEDD are finalising the scope of work for a price inquiry to the ICRC, which will be presented to the Treasurer and Minister for Water for consideration.
30. If agreed, the scope of work for the price inquiry to the ICRC will be drafted to indicate to the ICRC that consideration should be given to the relevant policy objectives such as environmental costs from water abstraction and the value of the water as a natural resource (scarcity value), as well as pricing and regulatory settings, and the cadence of subsequent reviews. Separate legal advice may be required to inform the review.
31. Should the review, if supported, identify there has been an under or overcollection of fees, the ACT will consider the recommended and most appropriate course of action for reconciliation with customers at that time.

Financial Implications

32. The work to be undertaken by the ICRC is expected to cost around \$100,000. This estimate is expected to be revised in consultation with the ICRC and upon finalisation of the scope of work. The cost of the advice is anticipated to be charged to Treasury under s12(5) of the *Independent Competition and Regulatory Commission Act 1997*. The investigation will be co-funded by EPSDD and CMTEDD (Treasury).
33. We expect the ICRC to advise on the most appropriate method to set Government water charges for 2024-25 and beyond. This will assist EPSDD and CMTEDD to estimate the financial implications of adopting the ICRC's advice.

Consultation

Internal

34. Early engagement has occurred with EPSDD Legal Policy. Discussions are ongoing.

Cross Directorate

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35. No Directorate outside of EPSDD and CMTEDD (Policy and Cabinet, and Treasury) have been advised of the findings of the Slattery and Johnson report.

External

36. The ICRC and Icon Water have been consulted on the practicality of passing through a potable WAC freeze to Icon Water customers in 2023-24.

Work Health and Safety

37. Nil for the purpose of this brief.

Benefits/Sensitivities

38. Increases in the cost of living are placing substantial financial pressure on the Canberra community. The ICRC's final decision for water and sewerage services for the 2023-28 regulatory will add to this pressure. The ICRC's final decision estimates that the combined water and sewerage services bill for an average household consuming 200kL a year will increase by 6.1 per cent on average over the regulatory period. In real terms (excluding inflation) the combined bill is expected to increase at an annual average of 3.1 per cent.

39. EPSDD and CMTEDD officials both agreed to develop a brief to freeze the increase of the WAC in 2023-24, although this was ultimately not recommended to ERC. This reflects consultation in June 2023 with Icon Water and the ICRC indicating that there was insufficient time to reflect a freeze in the 2023-24 water prices, and that any cost reductions could only be passed through to customers in 2024-25.

40. Cabinet will have the opportunity to consider the ACT Government's response to the Non-potable Water Review. The Minister for Water, Energy and Emissions Reduction will recommend an independent review of price setting for non-potable water. The proposal for the ICRC to examine the methodology for setting the 'water' charge addresses this recommendation and moves towards solution setting. Sensitivity in progressing and communicating the 'review' of ACT water charge methodology is advised.

Communications, media and engagement implications

41. No communications or media are proposed, noting the sensitives.

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Attachments

Att A	<i>Review on the reporting of the Water Abstraction Charge, Slattery and Johnson 2022</i>
Att B	Cost recovery and trend in fee increases