

Water Regulation in Australia

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Mr Jim Cox
CEO and Full Time Member

States, Major Cities and Rivers



Commonwealth State Relations

- ▼ Australia is a Federation of States and Territories (NSW, Queensland, Victoria, South Australia, Western Australia, Tasmania, ACT and Northern Territory).
- ▼ States and Territories have responsibilities for most utility service provision, including water.
- ▼ The Commonwealth and State governments meet and make national agreements under COAG (Council of Australian governments)
- ▼ Prolonged drought conditions in South Eastern Australia have brought water supply and management into sharp focus in these areas.

ACCC and IPART

- ▼ The ACCC (Australian Competition and Consumer Commission - The Commonwealth regulator) will progressively take over the regulation of bulk water in the Murray-Darling areas.
- ▼ This source of bulk water spans four states, and a separate Murray Darling Basin Authority has been established to manage this area.
- ▼ Other States – Structure of regulation regarding water utilities varies according to the states.
- ▼ NSW, Victoria have independent regulators that also make determinations on water prices. The Economic Regulation Authority in Western Australia regulates and licenses the provision of water services and makes recommendations in water prices. Other states have authorities that only provide recommendations.
- ▼ At present, IPART regulates both bulk water (mainly for

Role of IPART

- ▼ IPART is a state based economic regulator.
- ▼ IPART was established in 1992 by the NSW Government under the Independent Pricing and Regulatory Tribunal Act 1992.
- ▼ IPART's tribunal members are appointed by the NSW Premier, or chief minister.

Role of IPART

- ▼ Currently the Tribunal is comprised of a Chairman, a CEO/full time member and a part-time member.
- ▼ IPART's core functions include:
 - ▼ setting maximum prices for monopoly services
 - ▼ administering licensing of these services
 - ▼ administering the Greenhouse Gas Abatement Scheme.
- ▼ In addition, we are increasingly asked to provide policy advice to the NSW Government.

Resources and Processes

- ▼ IPART's budget for 2008/2009 is \$18M
- ▼ IPART has 90 staff members
- ▼ Consultative and evidence based processes are used in conducting reviews and determinations.
- ▼ During reviews submissions are invited from all key stakeholders, interest groups and members of the public.
- ▼ Groups putting forward submissions are given the opportunity to express their views at a public hearing.
- ▼ Draft reports are often used to obtain stakeholders views on decisions prior to finalisation.

Urban Water in NSW

- ▼ Sydney is supplied by Sydney Water Corporation/Sydney Catchment Authority;
- ▼ Three medium-sized suppliers – Hunter Water Corporation, Gosford City Council, Wyong Shire Council;
- ▼ Local government water authority suppliers;
- ▼ Highly variable rainfall;
- ▼ Supply is dominated by geographically isolated large dams;
- ▼ Little interconnection between systems although this is increasing;
- ▼ New sources of supply (desalination and recycling) are

Current Context of IPART Regulation

- ▼ Pressure for Price Increases to:
 - ▼ Pay for higher environmental standards
 - ▼ Fund replacement of aging infrastructure as well as demand management and water recycling policies
 - ▼ Offset higher input costs caused by competition from rapidly expanding mining sector
 - ▼ Place a greater reliance on price and less on water restrictions to reflect scarcity of resource
 - ▼ Offset Government decision to abolish developer charges
 - ▼ Bridge demand/supply imbalance resulting from
 - Population growth
 - Past deferment of major supply augmentations
 - Need to provide greater drought security

Current Context of IPART Regulation

- ▼ New supply side initiatives and issues include:
 - ▼ The construction of an expensive water desalination plant in Sydney
 - ▼ Planned construction of a new dam at Tillegra in the Hunter region of NSW has raised issues as to:
 - how new infrastructure should be funded;
 - how the costs should be split between beneficiaries;
 - the timing of cost recovery.
 - ▼ New pipelines and pumping facilities to augment capacity on the NSW Central Coast
 - ▼ Increased emphasis on water recycling, especially for non potable users.

The WICA Act

- ▼ There is increasing interest in competition in the water industry.
- ▼ The NSW Government introduced the Water Industry Competition Act in 2006 (WICA) to:
 - ▼ promote private sector innovation and
 - ▼ competition in the water industry.
- ▼ The Act establishes a licensing regime for private entrants to ensure the continued protection of public health, consumers and the environment.
- ▼ Licensees who supply water must obtain sufficient quantities from suppliers other than the public water utility

The WICA Act

- ▼ A private corporation must obtain a licence under the Act to construct, maintain or operate any water industry infrastructure or to supply water or provide sewerage services.
- ▼ Private operators have begun to apply for licenses in the Sydney area.
- ▼ The availability of new sources of water (desalination, recycling) increases the scope for competition in the supply of water.

IPART Act – Section 15 Factors

- ▼ In making determinations IPART is required to consider a broad range of social and economic issues. These include:
 - ▼ The cost of providing the services
 - ▼ The protection of consumers from abuses of monopoly power
 - ▼ The appropriate rate of return on public sector assets
 - ▼ The effect on general price inflation over the medium term
 - ▼ The need for greater efficiency in the supply of services so as to reduce costs
 - ▼ The need to maintain ecologically sustainable development by appropriate pricing policy

IPART Act – Section 15 Factors cont.,

- ▼ In making determinations IPART is required to consider a broad range of social and economic issues. These include:
 - ▼ The impact on pricing policies of borrowing, capital and dividend requirements
 - ▼ The need to promote competition in the supply of the services
 - ▼ Considerations of demand management (including levels of demand)
 - ▼ The social impact of IPART's determinations and recommendations

Pricing Elements

- ▼ Water
 - ▼ Fixed Service Charge
 - ▼ Volumetric (usage) charge
- ▼ Sewerage
 - ▼ Fixed Service Charge
 - ▼ Volumetric and trade waste charges for large non-residential properties
- ▼ Stormwater
 - ▼ Fixed or land area based charge
- ▼ Developer charges
- ▼ Recycled water charges

Pricing Elements

- ▼ Recent development of recycled water infrastructure has seen IPART determine prices for recycled water.
- ▼ Recycled water charges are development and system specific and are determined on a system basis.
- ▼ Environmental and system wide benefits.
- ▼ Pricing of recycled water depends on whether the schemes are voluntary or mandatory.
- ▼ IPART does not regulate voluntary schemes, however it has established a pricing framework for mandated schemes that must be followed.
- ▼ Developer charges for recycled water.

Pricing Elements

- ▼ The price setting approach of IPART has been structured to achieve full cost recovery.
- ▼ IPART uses a 'building block' methodology in order to determine an agency's revenue requirement.
- ▼ IPART assesses the future financial needs of the organization in determining the revenue requirement
- ▼ The revenue requirement must be sufficient to cover the operations, maintenance and administration expenses of the entity, plus a return of, and on, capital.

Pricing Elements

- ▼ The revenue requirement can be represented by the following formula (or 'building block' approach)

$$R = C + D + O + M + A$$

Where:

R= revenue requirement

C= return on capital

D= return of capital (depreciation)

O= operations expenses

M= maintenance expenses

A= administration expenses

Pricing Elements

- ▼ In its price review process, IPART reviews agencies' forecasts of operating and capital expenditure and assesses these for prudence and efficiency.
- ▼ IPART also reviews the water agencies forecasts of water consumption and yield.
- ▼ These elements assist in determining the price that will achieve full cost recovery.
- ▼ In setting the usage price for water, estimates of long run marginal cost are made.
- ▼ The Tribunal uses these estimates to guide it in setting the water usage price.

Pricing Elements

- ▼ Rate of return is assessed on the basis of the Weighted Average Cost of Capital. (WACC)
- ▼ WACC is expressed in real terms before tax.
- ▼ WACC for water industry is between 5-8% real pre-tax.
- ▼ WACC is applied to a regulatory asset base (RAB). The RAB is less than the replacement cost of assets.

Pricing Elements

- ▼ A line-in-the-sand approach has been used regarding asset valuation and cost recovery with respect to the water industry.
- ▼ Under this approach existing return levels on replacement costs are maintained for assets that existed at the time the line was drawn.
- ▼ For new investments and reinvestments in the business taking place after this date commercial based returns, reflecting the risk adjusted opportunity cost of funds, are sought.
- ▼ Through time the overall rate of return or replacement costs should increase as the asset base is turned over.

Price Regulation in Other States

- ▼ The NSW price regulation framework has been judged a success
- ▼ It has now been replicated in various forms in other state jurisdictions around Australia
- ▼ Victoria's Essential Services Commission is the most similar regulator to IPART and makes binding determinations.
- ▼ Other states have regulators that only provide recommendations on the prices proposed by water agencies.



Independent Pricing and Regulatory Tribunal

www.ipart.nsw.gov.au