

# Department of Treasury and Finance

Government of **Western Australia**

## Response to the Economic Regulation Authority Issues Paper

### Inquiry into the Tariffs of the Water Corporation, Aqwest and Busselton Water Board

September 2008

#### Disclaimer

The views expressed in this submission are those of the Department of Treasury and Finance and should not be taken to reflect the views of the Treasurer or the Government of Western Australia.

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## INTRODUCTION

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Traditionally governments have put in place policies that ensure everyone in the community had access to water for the basic purposes of drinking, cleaning and other health related purposes.

In Western Australia, this objective was first met through the provision of a free water allowance, which provided each household with a set amount of water free every year and only charged the household for their 'excess' water usage.

However over time it was considered important for water users to contribute at least in-part to the cost of their water demand, so the free water allowance was replaced by a nominal, discounted charge for that first amount of water.

Now with the adoption of reform measures in the 1994 COAG Water Reform Agreement and the National Water Initiative (NWI), governments are moving to full cost reflective charging for all water use. However, there are still many instances where the delivery of the original objective of ensuring water affordability (which in the case of Western Australia is through partial price uniformity across the State), is having a distortionary effect on water prices.

In Western Australia this has led to a number of issues which continue to restrict the use of price as an efficient mechanism by which to allocate resources in the community. These include:

- extended phase-in periods for full cost, best practice pricing, despite the need in these times of scarce water resources to develop increasingly expensive, climate independent source options;
- subsidised cost of water for everyone in regional areas despite record growth and increasingly high levels of disposable income for some residents in regional communities, either as a direct or indirect result of the mining boom;
- subsidised cost of water to mining companies in regional areas, that are housing their workforce and meeting the associated utility costs; and
- continued use of a property value based charge for residential wastewater, because the transitional impacts from moving to a more equitable charging regime unfairly impact those in the community in lower valued housing.

A suggested proposal to address these issues is the separation of full cost recovery of customer service charges from any welfare or social policy considerations that may be deemed necessary by the Government. It is not considered appropriate for social policy to be delivered through discounted water charges as such a broad approach will benefit even those without a proven need for such assistance. It is considered more appropriate for social policy to be delivered by more targeted means.

One way of achieving the separation would be to subject all consumers to the full cost and therefore the full price signal but provide a rebate to those consumers which the Government has identified as in need. Alternatively, those in need of financial assistance could be provided with free or at least heavily subsidised water, but any consumption above that level, is charged at full cost.

In addition to the issues listed in its Issues Paper, the Economic Regulation Authority (ERA) is requested to consider how best the Government can deliver its social policy objectives while subjecting all water consumers to full cost pricing signals.

The separation of such policies should be designed in such a way that the following objectives are still achievable:

- maintains the general intention of the uniform pricing policy which aims to ensure that everyone across the State has access to water for drinking and basic health purposes;
- targets those in real need of assistance;
- is an efficient method for the Government to provide targeted subsidies; and
- provides full cost pricing signals to manage demand and provide incentives for water savings.

Such a mechanism (in whatever form it took) could be enhanced by replacing the varying number of approaches utilised not only by retail service providers such as the Water Corporation and Synergy but also the Office of State Revenue, to deliver on the Government's entire suite of social policy objectives. Combining the delivery of all of these programs into a consistent mechanism across government would result in a more targeted delivery of the Government's social policies and a likely reduction in program administration costs overall.

The Productivity Commission provides support for a targeted social policy mechanism over the current approach of providing the subsidies through the pricing mechanism, as a way to improve the efficient allocation of resources.

Specific to the water industry, such a mechanism would also have the benefit of reducing demand for services (to the extent possible by the elasticity of demand for water) by exposing a greater portion of the community to the full cost of water. This would result in an overall increase in welfare to the community by allowing individuals to make informed decisions on their consumption of water and their uptake of water efficient appliances, rather than being subject to government imposed regulations.

The ERA is therefore also requested to take into consideration the potential outcomes such a targeted social policy mechanism could have for water pricing

and provide due consideration to the raft of reforms that would become possible under such a scenario.

The following responses to the issues raised by the ERA are therefore framed in this context of an enhanced movement towards full cost reflective pricing and the DTF looks forward to reviewing the ERA's draft report following its deliberations on these matters.

## GENERAL ISSUES

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### Service standards

1. Are the current levels of service appropriate?

The levels of services provided by the service providers, the Water Corporation and the Bunbury and Busselton Water Boards are generally a matter for the Department of Water and the responsible Minister.

That said, it is understood that all three providers are meeting their licensing requirements and the Department of Treasury and Finance (DTF) is not aware of any concerns in this regard.

### Water usage charges for Perth, Bunbury and Busselton

2. What pricing principles should guide the setting of water usage charges?

#### *Continued implementation of current price path*

The continued move towards long run marginal cost (LRMC) pricing for urban water, as per the ERA's 2005 recommendations, is supported.

LRMC continues to represent best industry practice for water pricing and should remain an integral part of water pricing in Western Australia. To that end, it would be appropriate for the ERA to undertake a recalculation of the LRMC for the Perth Integrated Water Supply Scheme (IWSS).

While the investigation of alternatives to the LRMC by the ERA is not opposed, it is noted that there is an increasing understanding of the LRMC as a "benchmark" cost of water which is important for the consideration of alternate mechanisms for saving water through efficiency measures.

#### *Price path towards full implementation*

In these times of scarce water resources and considerable investment in supply augmentation, there is an argument to be made that consumers should face the total cost of their supply decisions as a matter of priority.

It is therefore suggested that the existing price path towards full implementation of LRMC be the maximum phase-in time and there may be merit in a shorter phase-in period, especially if the transitional impacts can be lessened by a targeted social policy mechanism.

#### *Social policy (welfare) considerations*

As outlined above, the separation of full cost recovery of service charges from customers and any welfare or social policy considerations that may be

deemed necessary by the Government is supported. It is not considered appropriate for social policy to be delivered through discounted water charges as such a broad approach will benefit even those without a proven need for such assistance. It is considered more appropriate for social policy to be delivered by more targeted means.

#### *Charging structures for Bunbury and Busselton Water Boards*

The application of a consistent set of charging principles for all government owned service providers is strongly supported.

Under the proposed Water Corporations Bill, the Water Boards would become corporatised entities and subject to the same legislation as the Water Corporation. Therefore, as all three entities would have the same powers and functions, be subject to the same regulatory and governance arrangements and be able to compete in the same operating areas, it is absolutely critical that they should recover their regulated costs in the same manner.

#### *Scarcity pricing*

Any water charging principles that recognise and capture the opportunity cost of water are supported. However, there are a number of areas that need to be considered in far more detail (which are likely to include a number of barriers to be overcome) before such pricing structures could be implemented. These include, but are certainly not limited to, the following:

- i. the definition of scarcity and the appropriate trigger points and how those trigger points are affected by the advent of further climate independent sources;
- ii. the responsiveness and frequency of billing and the need for billing cycles to be in line with the changes to the prices charged (where those charges fluctuate); and
- iii. the ability of service providers to respond to the change in water scarcity through their billing systems.

It is suggested that further work be undertaken on these matters, as a separate exercise to this current pricing inquiry, so that the outcomes of any such investigations might be available for consideration in the next major pricing review, in 2013-14.

Further investigation into scarcity pricing would also be consistent with the recent recommendations of the Productivity Commission and the National Water Commission.

## Country water usage charges

### 3. Should country water usage charges be set in relation to marginal cost?

The link between the prices in the Perth metropolitan area and country areas via the uniform pricing policy (UPP) and the potential for over-charging in those country areas is acknowledged.

Therefore, the consideration by the ERA of alternative pricing structures that avoid such over-charging but deliver cost reflective pricing to country areas is welcomed. Such a balance of objectives, together with that of ensuring affordable water to those least able to afford it, would be readily achievable under the targeted social policy approach proposed earlier.

#### *Distortionary effects of the UPP*

In considering such options, there is no clear, theoretical reason why the ongoing relevance of the UPP as a mechanism cannot be examined, whilst still aiming for the achievement of the same objectives.

The UPP was designed to limit excessive price increases to country water customers due to the higher costs of service provision. One of the key assumptions underpinning the UPP was that country services would cost as least as much as the Perth metropolitan area and therefore that was taken to be the lower bound charge in the State. However, as the ERA suggests, with the increasing reliance on more capital expensive, climate independent, 'manufactured' water from desalination plants and recycling opportunities in the Perth IWSS, that base assumption may no longer hold true.

As a signatory to the National Water Initiative Intergovernmental Agreement (the NWI), the State is bound to continued movement towards upper bound pricing and full cost recovery, which could be achieved through the separation of water pricing structures and the delivery of the Government's social policy objectives.

The social objectives for water services could be assumed to have been defined in the UPP as the achievement of:

- affordable cost of water across the State at a consumption level considered to be the minimum for basic human needs (water for drinking, cleaning and sanitation purposes); and
- subsidised cost of water across the State, at a consumption level considered to be the average consumption of a household.

These parameters for the UPP were based on the assumption that country customers should not be penalised for living in the country areas by paying significantly higher water charges. However, while regional development is



supported, the ongoing 'broad-brush' nature of the subsidies provided to country areas through the UPP is not supported, on the grounds of a lack of efficiency in the allocation of the scarce resource. Continuing to provide such subsidies to country areas is clearly inefficient, resulting in a net welfare loss to the broader community.

A more appropriate alternative method of social policy delivery may be a targeted subsidy program which is means tested on an annual basis. With such measures in place to protect those less able to pay higher water charges, the opportunity to introduce greater cost reflective charging in country areas becomes a possibility.

#### *Alternate pricing mechanisms in the country*

Setting the social policy considerations aside, attention must now be turned to the possible alternative pricing mechanisms for country water customers. A pricing structure similar to the Perth metropolitan area using marginal cost pricing should be considered for country areas.

In developing such options, consideration will need to be given to those towns where the growth rate is minimal or approaching zero and the marginal cost of water supply is therefore quite low. In these instances it may be appropriate to consider alternate charging mechanisms that at least cover the operating and maintenance costs of water service provision, to ensure the ongoing supply of water is maintained.

### **Residential wastewater charges**

#### 4. Should residential wastewater charges be decoupled from property values?

The separation of residential wastewater charges and property values (value based charges) is strongly supported because of the considerable variation in prices charged, compared to the highly consistent level of services received. However, the transitional problems with moving from value based charges with such inherent inefficiencies is acknowledged, when customers in high value properties (and therefore possibly higher incomes) would likely receive a decrease in price whereas those in lower value properties (and therefore possibly lower incomes) would likely receive an increase in price.

Therefore, there is a need for the investigation of alternate and clearly separated and specifically targeted measures (for example a targeted rebate mechanism) to address the transitional problems as a means of enabling the removal of property value based wastewater charges.

#### *Third party access pricing*

In addition to the inefficiencies and inequities of property value based charges, there are also the problems which arise when considering access

pricing for wastewater infrastructure, that as evidenced in the New South Wales 'Services Sydney' example, rely on appropriate wastewater charging structures.

The recommended access price for the wastewater infrastructure of Sydney Water was determined by the Australian Competition and Consumer Commission (ACCC) to be a 'retail minus' approach. Such an approach is based on the basic principles of charging the access seeker the difference between the retail price of the services and the incumbent's avoidable costs.

Assuming therefore that any State based access regime is based on the New South Wales experience (as recommended by the ERA in its recent Final Report into Competition for the Water and Wastewater Services Sector), the continued use of valuation based charges for wastewater would heavily distort the access price payable to the incumbent and provide inefficient pricing signals to access seekers.

### **Non-residential wastewater charges**

5. Do interested parties have any concerns with the current approach to charging non-residential customers for wastewater services?

The number of fixtures is a reasonable proxy for determining service level demands from customers. Therefore, while adopting an alternative method is not opposed, a clear case would need to be made (including a cost benefit analysis) for the introduction of reforms to the structure of the charge given the very weak link between price and the demand for the service.

### **Charging for drainage**

6. What is the most appropriate charging basis for metropolitan customers for drainage services?

The current institutional structure of the drainage sector is considered to be more of a barrier to the efficient delivery of services than the current pricing regime. In any case, any property value based charging structure is opposed.

The current structure of the drainage sector in the Perth metropolitan area means that not all households receive a drainage service from the Water Corporation and therefore not all households pay a Water Corporation drainage charge. Households that are not drainage customers of the Water Corporation, are serviced by their respective local councils.

This arrangement gives rise to a number of cross-subsidies, which are most clearly articulated in the case of the riverside foreshore and other communal areas such as Kings Park. Both of these areas are drained by the Water Corporation and therefore funded by the Water Corporation's drainage customers but the entire community benefits from the drainage of those

areas. Therefore, any reforms to drainage pricing, will only impact the Water Corporation's drainage customers and not those serviced by their local councils, despite both customer types receiving the same levels of service.

The yet to be finalised Department of Water review of drainage structures should be released before any reforms to pricing are contemplated. However, if that process is unable to deliver a result, then a fixed charge payable by all households is the preferred approach.

The link between levels of service demand and price are practically non-existent for drainage and therefore the most efficient and equitable pricing structure would be a flat charge, that recovers the cost of delivering the service equally from all those who benefit.

7. Should customers in country towns pay for drainage services provided by the Water Corporation?

The cost recovery of drainage services from customers in country towns is strongly supported. How that should occur and whether there are any transitional considerations need to be cognisant of the following:

- the levels of service provided to country drainage customers and whether that level of service is different in the towns compared to the more regional country areas;
- the rationale for calculating a scheme by scheme method of cost recovery or whether, given the disparity between price and service level demand, a Statewide charge is more appropriate; and
- whether there is any scope to provide pricing or funding incentives to the service provider to seek and enhance drainage quality outcomes.

Further consideration of these matters by the ERA is encouraged and the DTF looks forward to reviewing any subsequent options for introducing drainage charges to customers in country towns.

### **CSO payments**

8. Are current CSOs consistent with the objectives sought by government?

Community service obligation payments (CSOs) are paid to government owned service providers for those activities which the Government seeks the cooperation of the service provider to deliver on its behalf, which it would not otherwise undertake due to the lack of a commercial return.

The areas for which the Water Corporation currently receives CSO payments appear consistent with the associated policy objectives and the current

approvals in place for its annual CSO payments ensure that continues to be the case.

Of more importance is the level of CSOs paid and the extent to which that represents 'value for money', the existence of any efficiency incentives on the service providers and the existence of any competitive pressures (either real or perceived) on the continued improvement in the delivery of the CSOs.

9. Are current CSOs value for money or should they be modified in some way?

The achievement of value for money in the delivery of CSOs is of paramount importance. A review of the delivery of such services by government trading enterprises is proposed to be undertaken during the 2009-10 budget process.

That said, the input of the economic regulator in these considerations is always useful and any advice the ERA may have in this regard is most welcome.

Furthermore, the consideration by the ERA of any enhanced efficiency targets which could be introduced into the CSO payment arrangements would be useful. Such efficiency targets should seek to bridge the gap between the benefits of public ownership and the shareholder scrutiny placed on private sector companies and the pressure that therefore places on that company to continue to seek efficiency improvements across all aspects of its business.

10. Should the uniform tariff threshold be changed?

As indicated above, there is sufficient evidence to suggest that the mechanism of the UPP could be reviewed and social policy objectives delivered in a more targeted manner than the current broad approach to all country customers.

11. Should discounts be provided for non-discretionary water usage, such as the first 150 kL of annual water usage?

Subsidised pricing of non-discretionary water usage provides inefficient incentives for other water saving measures around the home and leads to an overall welfare loss to the community.

Full cost recovery for all water usage provides households and businesses alike with the right incentives to either manage or conserve their water usage (through voluntary conservation or the use of water efficient technology) or to elect to use as much water as the individual chooses to.

Even at a high end LRMC estimate of \$2.00 per kL, average discretionary use of 150kL per annum equates to less than \$6 per week and is therefore not considered to be cost prohibitive. That said, if there are members of the community facing difficulties in meeting the cost of such basic services, such

matters should be addressed with targeted social policies, rather than distorting the entire pricing structure.

12. Should very high volume water users pay a penalty rate?

Full cost recovery does not advocate over-charging for water consumption, just as it does not advocate under-recovering for such consumption. However, the problem faced in Western Australia and across Australia to varying degrees is that full cost recovery of water services does not include the recovery of the costs of water resource management and planning, nor does it include the cost of environmental and other externalities.

While these concepts are discussed in further detail below, it is important that they be outlined here in support of this discussion point.

The costs of resource management and planning and the broader costs of environmental externalities are becoming increasingly significant in these times of scarce water resources (which require greater management planning to ensure their ongoing sustainability) and increasing reliance on desalination (which is just one example of a source option with environmental externalities).

Therefore, while ideally these costs would be recovered from users (and to a greater extent from the high volume water users) in the current situation where these costs are not recovered, there may be an argument for a proxy of these costs to be recovered.

That said, such proxy costs would reasonably be recovered from all users equally (based on their levels of demand) because each user contributes to the need to incur these costs equally.

**Demand management**

13. Should demand restrictions and other demand management measures continue in the metropolitan area given the construction of the second desalination plant?

The decision whether to retain sprinkler restrictions after the commissioning of the Southern Seawater desalination plant will be an important decision for the Government of the day. In considering its options, the following matters will need to be considered:

- the general government sector operating surplus would be improved in the short term if restrictions were removed, primarily due to the increase in water sales revenue (and associated dividends) by the government owned retail service providers;

- in the longer term, because sprinkler restrictions reduce demand, removing those restrictions may necessitate the earlier development of a new water source, which would increase pressure on the State's net debt levels;
- water restrictions, together with the adoption of improved water efficiencies, have led to a shift in consumer behaviour which may not be reversed, or at least will only be partially reversed, if sprinkler restrictions are abolished. The quantum of this shift in consumer behaviour will directly impact on the level of supply augmentation in the longer term;
- sprinkler restrictions impose costs to the community (the Productivity Commission estimates those costs at \$67 per householder per annum) and there is an argument that if the community is willing to pay the full cost of their water demand (which is the sum of the long run marginal cost of supply and the costs of the associated externalities), then their supply should not be arbitrarily limited by government regulation; and
- permanent water restrictions were mandated throughout the State in October 2007 and the removal of sprinkler restrictions would be inconsistent with the achievement of the target of 100kL annual per person consumption levels for household use by 2012, as outlined in the 2007 State Water Plan.

14. Should demand restrictions be determined on a scheme-by-scheme basis as opposed to North and South of the State?

The consideration of demand restrictions on a scheme by scheme basis is strongly supported.

The current Statewide restriction regime imposes unnecessary financial and welfare costs on the community when it is forced to abide by regulated restrictions with little or no consideration on the local characteristics of climate, rainfall and water supply.

An example of this is in the Bunbury and Busselton regions where it is understood that any water that is not consumed from the South West Yarragadee aquifer discharges to the ocean.

**Environmental externalities**

15. Should tariffs be adjusted to take into account any environmental externalities, and if so, how?

The State is bound to comply with the recovery of environmental externalities as a signatory to the NWI and further consideration, definition and eventual introduction of measures to capture the costs of such externalities is important.

However, from a practical implementation perspective, the recovery of environmental externalities is considered a second order charge and there are higher order externality charges related to water resource management and planning that should be introduced prior to any mechanism that recovers the costs of environmental externalities.

The first externality charge that should be introduced as a priority for appropriate water resource management in Western Australia is one that recovers the costs incurred in ensuring water users have a legally defensible right to take water from the natural groundwater or surface water system. The costs incurred by governments in ensuring this are firstly a licence administration fee and secondly, a water resource management and planning charge.

As indicated in previous forums, the DTF considers the introduction of these charges to be of paramount importance, primarily for the establishment of an effective water trading market, which has obvious flow on effects to potable water supply as an alternative supply option available.

#### *Complications with recovering costs of externalities*

Given the intangible nature of some environmental externalities, a significant amount of work is required to define the externalities and determine an economically efficient method of recovering those costs.

At present, no Australian jurisdiction has successfully defined and sought to recover such externalities and given the lack of progress to date to introduce even a first order licence administration charge, the recovery of environmental externalities may need to be deferred at this time.

That said, further work should be undertaken in this instance so that such charges could be introduced at the time of the next major pricing inquiry.

## TECHNICAL ISSUES

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### Scope for efficiency gains – operating expenditure

16. Should efficiency targets distinguish between 'catch-up' efficiency gains and 'continuing' efficiency gains?
17. Should the development of incentives incorporate both carrot and stick incentives?
18. Should efficiency targets apply to total operating expenditure or to a measure that excludes changes in operating expenditure due to improvements in service levels?

The application of efficiency targets to government owned service providers that reflect the conditions of a privately owned entity, in a competitively neutral manner, is supported.

Issues to consider in the application of incentives to public corporations include the following:

- the attitude of the Board of the corporation in its approach to balancing its dual objectives of profit maximisation and the provision of a retail service on behalf of the Government;
- the existing efficiencies of the corporation and the scope for any further gains;
- the level of cost recovery versus the use of direct subsidies and whether there are any price based efficiency incentives that may be applicable; and
- the governance arrangements of the corporations and the scope of the Board to make commercial decisions without being 'weighed down' with the obligation to deliver on the Government's social policy agenda, especially if there are cross-subsidies between the commercial and non-commercial streams of the business.

The ERA is encouraged to consider these issues and provide a range of options for the Government to consider for the provision of appropriate efficiency incentives to its service providers.



### **Scope for efficiency gains – capital expenditure**

19. In reviewing each water utility's processes for undertaking capital expenditure, are there any particular matters the Authority should consider?

The DTF is currently reviewing the recommendations of the ERA's Competition Inquiry, in regards to the Water Corporation's bulk water procurement strategy and therefore will avoid any comment on that issue at this time.

However in regards to the broader capital program of each of the government owned service providers, the DTF supports the alliance contracting undertaken by the Water Corporation as a means of attracting private sector participation and introducing competitive pressures to its infrastructure development program.

Further to the discussion on efficiency incentives above, the ERA is encouraged to consider and make recommendations on the provision of appropriate incentives to the service providers in the delivery of its capital expenditure programs.

### **Rate of return**

20. The Authority invites the water utilities and others to consider appropriate parameters for determining the rates of return.

In regards to this matter, the DTF welcomes the advice of the ERA on an appropriate set of parameters for the determination of a rate of return for the government owned service providers.

In considering this issue, the application of competitively neutral parameters is considered to be the most appropriate. Such matters to consider in the calculation of a rate of return for each of the service providers would be its legislatively protected customer base and the availability of debt funding at below market rates through the Government's Treasury Corporation.

For the determination of the Weighted Average Cost of Capital, the ERA is requested to consider the application of the methodology it has determined to apply to the cost of capital for covered electricity networks as an appropriate basis for the water service providers.

## **Cost allocation**

21. Should the current method for allocating costs of water service provision in the metropolitan area between residential and non-residential customers, which is based on maintaining existing relativities, be modified in some way to achieve a more cost reflective allocation of costs?

A cost allocation model based on the volume of demand from customers is the most appropriate approach. That said, the outcomes of the modeling for such an approach will be important because the DTF would prefer a minimisation of the recovery of costs via the fixed charge from residential customers because of the dilution effect that would have on the effects of the price signal.

22. Should the current method for allocating costs of wastewater service provision in the metropolitan area between residential and non-residential customers, which is based on maintaining existing relativities, be modified in some way to achieve a more cost reflective allocation of costs?

A volumetric based approach to the apportionment of costs between the residential and non-residential sectors would appear to be the most appropriate approach.

23. Should country non-residential wastewater charges be set equal to metropolitan non-residential wastewater charges?

The application of cost reflective charging should not necessitate the setting of one charge equal to another simply for administrative reasons.

In regards to the review of relative cost allocations and the subsequent, alternate pricing approaches potentially recommended by the ERA, the DTF requests that a range of options be presented to the Government. This is due in part to the varied nature of the structure of charges in these sectors and the potential for the transitional impacts to be substantial and produce unintended distortions across the sectors.

Furthermore, the ERA is requested to consider how these transitional impacts could be averted or at least minimised through the use of a more targeted social policy mechanism, as outlined above.

## **Treatment of inflation**

24. What is the appropriate inflation measure to apply to the escalation of tariffs on an annual basis?

The DTF requires its government owned service providers to use the 'Budget rate' which is based on the actual, annual rate of inflation measured to September each year.

That said, any further information the ERA can provide regarding an alternative regulatory approach to the treatment of inflation would be welcomed.

### **Treatment of underground network assets**

25. What is the appropriate treatment of infrastructure network assets for the purpose of determining the revenue requirement for a water utility?

Regardless of the approach recommended by the ERA on this issue, it should ensure that each of the service providers is afforded the opportunity to maintain its network assets in accordance with its licensing conditions.

Furthermore, any recommendations made by the ERA on this matter should clearly articulate to the Government the pros and cons of any alternative approach for the treatment of the infrastructure network assets.

### **Treatment of developer contributions**

26. How should the Authority treat developer contributions in its financial modelling of water utilities?

In support of the current approach is the fact that it ensures the asset base represents the total value of the company. That said, it also allows the company to earn a rate of return on its gifted assets, which to some degree appears inappropriate given that the company did not invest either its debt or equity into the construction of those assets.

Alternatively, the approach adopted by the New South Wales IPART and the Victorian ESC fails to reflect the full value of the company by excluding the gifted assets from the asset base.

It is understood that the ERA is considering this issue in the context of the electricity industry and the question of appropriate access to Western Power's transmission assets. As there would appear to be a strong case for consistency between the two utility industries, the ERA is requested to consider the matter in this context.

## **ISSUES SPECIFIC TO EACH UTILITY**

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27. Are there any issues specific to each utility that warrant particular attention?

Other area the ERA may wish to inquire and recommend on, include:

- the calculation of the price elasticity of demand for each of the service providers, as a useful tool in the determination of the effect of using price as a demand management tool; and
- the appropriate length of time for a further review of prices charged by the service provider. The Water Corporation and the Water Boards to a lesser extent have been subject to a number of pricing reviews over the last four years. Going forward, it is considered that a pricing review every three years will provide a reasonable balance between the impost it places on the service provider and the ongoing need to review the appropriateness of water prices at regular intervals.