

8 Australian Capital Territory

Outstanding assessment issues

Full cost recovery — urban

Outstanding issue: The Council is to revisit the ACT Government's dividend policy to address whether a payout ratio of 100 per cent is consistent with CoAG commitments.

Next full assessment: The Council will assess urban pricing reforms in 2003.

Reference: Water reform agreement, clause 3(a)

Background

The ACT Electricity and Water Corporation (ACTEW) — a Government-owned corporation — paid a dividend of \$65.7 million to the ACT Government in 1999-2000. This payment amounted to the whole of ACTEW's profits in that year. The 1998-99 payment of a \$45.7 million dividend also accounted for all of ACTEW's profits. The ACT Government advised that the dividend target from 1997-98 to 2000-01 was to be based on 100 per cent of after-tax profits, although the actual dividend payment was subject to the circumstances and trading results of each year.

For the 2001 National Competition Policy (NCP) assessment, the National Competition Council raised concerns that limited reserves were being retained within ACTEW for future investment and growth. The Council was satisfied with the measures in place to value and maintain existing assets, but is concerned that a payout ratio of 100 per cent does not leave funds within the business for new investment, provision for population growth, or unexpected investment (such as in the case of facility breakdown). In these circumstances, ACTEW would have to increase its debt or the Government would have to provide an injection of capital.

ACT arrangements

ACTEW paid a dividend of \$15.2 million to the ACT Government in 2000-01 for its water service operations. This again equates to a dividend payout ratio

of 100 per cent of after-tax profits [earned in respect of water operations]. Dividends are capped in that they can only be paid out of profits and prior retained earnings.

Discussion

Given that the 100 per cent dividend distribution arrangements for ACTEW remain, the Council has considered whether the lack of retained earnings within the business is affecting ACTEW's ability to manage future growth or provide for new unanticipated investment. The Council is looking to ensure the ACT's dividend policy is consistent with the Council of Australian Governments (CoAG) guidelines that require dividends, where provided, to reflect commercial realities and simulate a competitive market outcome.

Competitive capital structure

The ACT argues that dividend policy should be driven by ensuring that a Government business enterprise has a competitive capital structure. ACTEW's planned debt ratio for the end of 2001-02 is 38 per cent and has been much less in past periods. The 100 per cent dividend policy has assisted in moving ACTEW's capital structure closer to an efficient level based on industry practice. The ACT reports that the industry average debt ratio for utilities in the water/electricity industry is 40 per cent for 2001-02. Considering this argument, the Council asked whether the 100 per cent dividend distribution policy would remain standard once the capital structure was optimised. The ACT states that the dividend policy will be reviewed, accounting for ACTEW's operational cash flows and capital requirements where appropriate.

Role of the Independent Competition and Regulatory Commission

The Independent Competition and Regulatory Commission considers ACTEW's long term capital expenditure needs (including the need for new investment to accommodate growth) when setting prices for regulated services (which include all water and wastewater services). The regulatory regime requires assets to be maintained at a minimum standard, with significant penalties (including loss of license) for noncompliance.

The *Independent Competition and Regulatory Commission Act 1997* provides that in determining price directions for regulated industries:

...the commission shall have regard to the borrowing, capital and cash flow requirements of persons providing regulated services and the need to renew or increase relevant assets in the regulated industry. (s. 20)

Sources of finance for further capital investment

The ACT argues that ACTEW has numerous options for financing changes to its capital base.

- ACTEW can seek adjustments to its dividend payout ratio, subject to a material change in ACTEW's costs or revenues for any year. The ACTEW Board recommends a final dividend to voting shareholders (the Chief Minister and Treasurer) that may vary the standard 100 per cent dividend distribution. The voting shareholders have final discretion regarding the level of ACTEW's dividend after considering the advice of the ACTEW Board.

The ActewAGL joint venture conducts most of ACTEW's business operations including managing ACTEW's water and sewerage businesses via contract. The joint venture has several partnership agreements, one of which provides for partners to agree to the distributions to be made in each financial year. In the absence of any agreement, the partnership must distribute all surplus funds over operating and capital expenditure requirements. These provisions ensure surplus funds are distributed to ACTEW and AGL.

- ACTEW can use funds accumulated in the form of deferred income tax equivalents. The ACT argues that these funds effectively provide ACTEW with a source of cash for future capital investments. The combination of tax losses and accounting profits has led to it accruing a provision for deferred income tax equivalents.
- ACTEW can increase its borrowings.

Assessment

The Council remains concerned about ACTEW's dividend payout ratio of 100 per cent of after tax profits. There are, however, some mitigating factors relevant to the Council's assessment:

- The practice of distributing all earnings does not exceed the requirements of the *Corporations Act 2001*, under which dividends may be paid only out of current year profits and accumulated retained profits.
- The Independent Competition and Regulatory Commission provides price directions that are set with regard to, amongst other things, the long-term capital expenditure needs of the business.
- Governing legislation and licences for ACTEW set appropriate standards (including investment in replacing, upgrading and maintaining the infrastructure needed to provide services at those standards) and enforceable penalties for any breach of a service standard.

- The ACT has stated that it is using high dividend payouts as a means of capital restructuring. Whilst this practice is not ideal because of the lack of transparency, it is one way of raising ACTEW's debt ratio from the low levels of the past.

Given these considerations, the Council is satisfied that the ACT's current dividend policy is not inconsistent with the CoAG commitment. The approach, nevertheless, is not ideal, and there is a question whether full distributions should continue in the longer term once ACTEW's debt ratio is more in line with the market average. The Council will revisit this issue in 2003 when a broad review of dividend policy of all jurisdictions will take place.

Consumption-based pricing

Outstanding issue: The ACT is to address concerns that ACTEW does not have trade waste charges.

Next full assessment: The Council will assess urban pricing reforms in 2003.

Reference: Water reform agreement, clause 3(b)

Background

ACTEW supplies metropolitan water and sewerage service. ACTEW and AGL recently formed a joint venture (ActewAGL) to improve the performance of the Territory's water, wastewater and energy services. Under the new partnership arrangements, ACTEW retains the ownership of water and wastewater assets. Service delivery is contracted to ActewAGL.

For 2001, the Council understood that ACTEW did not levy trade waste charges. An application could be made to ACTEW to discharge trade waste into the wastewater system, and ACTEW could place conditions on the applications' approval to ensure no adverse effect on the fabric or operation of the system. These conditions could include:

- limiting the nature, components and characteristics of the waste;
- limiting the total daily and average peak volume that may be discharged;
- requiring that a specific waste treatment or management process be used; and
- requiring storage facilities be used to control the rate of discharge.

At that time, the Council strongly urged the ACT to move towards a trade waste charge. The absence of such a charge, reflecting both the quantity and quality of the waste, provides scope for nontransparent cross-subsidies and has the potential to undermine the CoAG-endorsed principle of consumption-

based pricing. The Council said it would look for this matter to be substantially addressed in 2002.

ACT arrangements

For the 2002 NCP assessment, the ACT Government reports that a systematic trade waste charge based on volume and toxicity of waste has not been introduced. ACTEW had previously reviewed the need for a trade waste charge and found no significant cost impact from trade waste discharges. This stems from a predominantly domestic and light commercial consumer base finding, and the absence of a substantial industry. ACTEW's trade waste approvals system is now operational as an asset protection mechanism. In a few instances, however, ACTEW has applied a specific charge tied to the volume and toxicity of the discharge.

Three large waste disposal sites have special trade waste contracts. These activities include run-off from a municipal tip, winery waste and water discharged from swimming pools. In each case, the site operators have cooperated with ActewAGL to reduce discharges and control the nature of discharges by on-site pre treatment or by timing the discharge to reduce the level of impact on the sewerage system and treatment plant to acceptable levels consistent with the contract charges paid by those customers.

A number of other major producers of waste are required to either pre-treat or prevent prohibited discharges to the sewer under an approvals process that is being reviewed.

Discussion

The absence of a trade waste charge, reflecting both the quantity and quality of the waste, provides scope for nontransparent cross-subsidies and has the potential to undermine the CoAG-endorsed principle of consumption-based pricing. ACTEW has not yet fully considered a systematic trade waste charge tied to quantity and quality of waste.

The ACT continues to argue that trade waste type discharges may be more effectively and economically managed via a sewer acceptance charge where these users contribute to the cost of discharge monitoring and any extra treatment costs arising from trade discharge to sewers. The ACT Government states that a systematic trade waste charge would need to be implemented on the basis that such a pricing approach would yield an improvement in economic efficiency via better resource allocation.

The Council agrees with the ACT view that the Government needs to properly evaluate the merits of such a charge before introducing a systematic trade waste charge in the ACT. The ACT argues that this approach cannot in any way be construed as undermining the principle of consumption-based pricing espoused in the CoAG pricing framework. It requires a proper economic

analysis of the costs of carriage and treatment of trade wastes, and an awareness of alternative disposal and treatment options.

Overall, the Council has not been provided with sufficient information to verify that the absence of a trade waste charge does not provide scope for nontransparent cross-subsidies or undermine the CoAG-endorsed principle of consumption-based pricing.

While continuing to operate under a trade waste approval system, the ACT Government committed to reviewing the merits of a systematic charging arrangement for trade waste. The time period suggested for completing this task is 18 months. The analysis will provide evidence of whether major revision of sewerage charging arrangements, with increased use of trade waste agreements for business sites, improves economic efficiency via better resource allocation.

The Council has advised the ACT Government that the 18-month period to review charging arrangements for trade waste extends beyond the 2003 NCP assessment, when full implementation of urban pricing reform is expected. To meet the reform commitments for the 2003 NCP assessment, the ACT will need to have independently analysed and developed its systematic charging arrangements for trade waste charges, and have a clear implementation strategy by June 2003.

Assessment

The Council remains concerned that the ACT has not provided information to demonstrate that the lack of a systematic trade waste charge for high volume or toxic waste dischargers does not lead to nontransparent cross-subsidies. The potential exists for these waste dischargers to pay less than the incremental costs they impose on the system, and accurately identifying and reporting any cross-subsidies arising from current pricing arrangements would be very difficult. The Council expects ACT Government to have independently analysed and, if cost effective, developed its systematic charging arrangements for trade waste charges, and have a clear implementation strategy by June 2003.

2002 Progress report only

Full cost recovery: externalities

Progress report: Developments in factoring externalities into pricing by urban service providers

Next full assessment: The Council will assess urban pricing reform in 2003.

Reference: Water reform agreements, clause 3(a)(i); Expert Group report on externalities

Background and ACT progress

For the 2001 NCP assessment, the Government reported the establishment of a 10 cent per kilolitre water abstraction charge, that was in the 1999-2000 Budget. This covers externalities and the scarcity value of water, and applies to all customers including urban customers. The Independent Competition and Regulatory Commission directed that the water abstraction charge be treated as a direct pass-through and shown separately on the water bill. In making its direction, the Commission stated that:

For the water abstraction charge to have the desired effect in terms of signalling the scarcity value of water and the environmental costs associated with its use, the Commission considered that it was desirable that there be a pass through of the charge in a manner such that final consumers could both identify the cost involved and were required to pay that cost. (IPARC 2000, p.5)

The 2001 arrangements are continuing.

Full cost recovery: tax equivalent regimes

Progress report: Developments to implement tax equivalent regimes for metropolitan service providers

Next full assessment: The Council will assess urban pricing reform in 2003.

Reference: Water reform agreements, clause 3(a)(i); Expert Group report on TERs

ACT progress

The ACT reports that ACTEW is subject to all relevant Commonwealth and ACT taxes and tax equivalents, as required under the *Territory Owned Corporations Act 1990* (ss. 29 and 30B).

Institutional reform: structural separation

Progress report: Finalisation of the benchmark customer contract and utility services licences, and establishment of other relevant industry codes.

Next full assessment: The Council will assess institutional reform in 2003.

Reference: Water reform agreement, clauses 6(c) and (d)

Background

Since passing the *Utilities Act 2000* the ACT Government has made substantial progress in implementing institutional reform. At the time of the

Council's 2001 NCP assessment, however, that implementation was not complete. In particular, the benchmark customer contract and utility services licence were released as discussion drafts only in February 2000 and they were not expected to be finalised until July 2001. Further, the Council had not seen copies of any other codes of practice relating to the water sector. Overall, the Council noted that it would look at these issues in 2002 to identify whether:

- the benchmark customer contract and utility services licence have been finalised;
- any other relevant industry codes have been established; and
- in practice, these arrangements are delivering sufficient institutional separation to provide for transparent rigorous regulatory processes.

ACT progress

The ACT has now approved a standard customer contract, industry codes and ACTEW's utility services licence. The standard customer contract is available on the ActewAGL website (ActewAGL 2002). The contract sets out the standard terms and conditions for the supply of water and sewerage services to customers in the ACT. It also sets out the obligations of both ACTEW and its customers. The contract specifies how customers can make inquiries and complaints, and refers to dispute resolution procedures.

A range of industry and technical codes covering the water industry are available on the Independent Competition and Regulatory Commission website. These include the customer protection code (ACT Government 2000a) that:

- outlines the basic rights of customers;
- defines the circumstances in which the water utility can interrupt, restrict or disconnect supply;
- outlines the obligations of the utility in dealing with customers; and
- sets out the provisions that must or may be included in the customer service contract.

The technical codes cover issues such as:

- the system used by the water utility to grant accreditation, and the requirements for a person to become accredited, to undertake work in connecting to the water or sewerage network (ACT 2000b);
- the development of service and installation rules for connecting a customer's premises to the sewerage network (ACT 2000c);

- mechanisms to ensure dams are managed safely (ACT 2000d);
- minimum standards for the design, construction, preparation and maintenance of water and sewerage networks (ACT 2000e);
- matters that relate to water metering (ACT 2000f);
- minimum standards for the quality and reliability for water and sewerage services (ACT 2000g); and
- the definition of the boundaries between water and sewerage networks and customer premises (ACT 2000h).

The utility services licence (ICRC 2001) sets obligations on ACTEW in relation to its operations, environmental obligations and participation in benchmarking processes. The licence specifies that ACTEW must comply with the licence, relevant codes and the *Utilities Act 2000*. ACTEW must monitor its compliance and report annually to the Independent Competition and Regulatory Commission. A summary of that report is publicly available. An independent expert, approved by the Independent Competition and Regulatory Commission, must occasionally undertake an audit of compliance.

Water trading

Progress report: Resolution of a lack of rules governing interstate trade of water in the Murrumbidgee and Murray rivers and the adoption of the Murray-Darling Cap

Next full assessment: The Council will assess interstate trading arrangements in 2004.

Reference: Water reform agreement, clause 5

Background

For the 2001 NCP assessment, the Council noted that the finalisation of trading rules between New South Wales and the ACT needs to await amendments to legislation in New South Wales as part of that State's more general review of the water market in the Murrumbidgee Valley. The expansion of the Murray–Darling Water Trading Pilot could eventually enable the ACT to trade with the River Murray in New South Wales, Victoria and South Australia, although the arrangements for this market are unlikely to be developed for at least two years.

The ACT component of the overall Murray–Darling Basin Commission (MDBC) cap on water extraction is under negotiation. The ACT participated in the Murray–Darling Basin initiative from March 1998 and agreed to participate in the cap initiative, but there has been no decision on what the ACT cap should be.

The 2001 NCP assessment recognised that the ACT could not implement interstate trading arrangements alone. It acknowledged the proactive steps the ACT had taken to progress these issues.

ACT progress

The ACT is pursuing interstate trading rules within the MDBC context. It is a participating member in the MDBC Water Market Reform Working Group, which is the Commission's primary group dealing with trading issues. The ACT indicated, however, that it would not agree to trading rules that disadvantage the ACT or that would lead to increased environmental degradation.

The ACT reports that it is also the industry sponsor of an academic (PhD) scholarship into possible conditions of water trading in the ACT.

In regard to the MDBC water diversion cap, the ACT has not yet agreed to a final cap, because the rules for water trading are still to be finalised. When these rules are finalised, the Government said that it would be in a position to determine a cap that is reasonable for the ACT. In the meantime, it has adopted a relatively conservative upper limit on water use, independent of the MDBC, based on the ACT environmental flow guidelines.

The ACT, to progress the issue of trading, has opened direct discussions with New South Wales to come to an arrangement that allows the ACT to be comfortable with a cap based on bilateral trading with New South Wales rather than a guarantee of cross-basin trading.