



ACT AUDITOR-GENERAL'S OFFICE



MEDIA RELEASE

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The Water and Sewerage Pricing Process Audit

ACT Auditor-General, Dr Maxine Cooper, today presented a performance audit report on **The Water and Sewerage Pricing Process** to the Speaker for tabling in the ACT Legislative Assembly.

The audit was initiated as a result of assertions made by the Independent Competition and Regulatory Commission (ICRC) that ACTEW was '*obstructing the Commission in fulfilling its regulatory functions*' by not providing information for the purpose of the water and sewerage pricing process. The ICRC asserted that '*whilst it [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*' and that '*the actions and inactions of ACTEW [posed] a threat to the public interest*'.

Dr Cooper said:

The assertions are not supported by evidence. Furthermore, the administrative and communication processes associated with the 2013 water and sewerage pricing process have been found to be ineffective and inefficient. In particular, the water and sewerage pricing process has been characterised by poor communication and a poor relationship between the ICRC and ACTEW.

As a result of the findings an overall recommendation, key to improving future water and sewerage pricing processes, calls on the ACT Government to:

... review the water and sewerage price setting framework including legislative, governance and administrative arrangements.

Dr Cooper also said:

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 advised that '...the Price Direction made by the ICRC...is invalid' because the terms of reference issued by the Treasurer was insufficient. This and other issues indicate the importance of a review.

The report highlights the role of communication, and in this regard Dr Cooper said:

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 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.

In undertaking the audit, the Audit Office sought to have open communication with auditees. Specialist advice was used and audit work was independently scrutinised. For example:

- three versions of draft and proposed reports was provided to all auditees between November 2013 and March 2014 and auditees were invited to meet with the Audit Office to discuss issues;
- legal advice was provided by the Australian Government Solicitor and Mr Peter Hanks QC, who is well known for his administrative law expertise;
- an external quality assurance review of the draft report was undertaken; and
- Mr Des Pearson, a former Auditor-General of Victoria and Western Australia, examined the Audit Office's consideration and acquittal of auditee responses to draft and proposed reports.

Dr Cooper said:

Given the nature of the audit some interviews with the ICRC and ACTEW (and ActewAGL) were undertaken under oath or affirmation, pursuant to section 14A of the Auditor-General Act 1996.

In addition to the overall recommendation seven other recommendations are made. These and further information are included in Chapter 1 of the report which is included as an attachment to this media release.

Copies of the report are available from the ACT Auditor-General's Office website www.audit.act.gov.au and the Office (please phone 6207 0833 or go to 11 Moore Street, Canberra City)

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.