Australian Competition & Consumer Commission

A guide to the water charge (infrastructure) rules:

Pricing application for Part 6 operators

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Abbreviations

ACCC	Australian Competition and Consumer Commission
the Basin	Murray–Darling Basin
operator	infrastructure operator
WCIR	Water Charge (Infrastructure) Rules 2010

Glossary

This glossary endeavours to provide practical meanings of terms. Readers may need to consider the legal meaning of some terms under the *Water Act 2007* (Cth) and obtain legal advice on these definitions, if required.

administration expenditure	All operating expenditure that is not operations expenditure or maintenance expenditure. This may include billing, customer enquiries, corporate support, board management, and interest payments.
capital expenditure	Includes expenditure on: new works renewals or replacements other expenditure that would otherwise be referred to as capital.
infrastructure operator	A person who owns or operates water service infrastructure for one or more of the following purposes: the storage of water the delivery of water the drainage of water for the purpose of providing a service to another person.
infrastructure service	Access, or a service provided in relation to access to water service infrastructure and includes the storage, delivery, drainage and taking of water.
maintenance expenditure	Expenditure associated with asset maintenance and repair
managed water resources	All water resources that are: Basin water resources water resources (not being Basin water resources) in a referring State, or part of a referring State, if • a law of the referring State provides that section 100B of the Act applies to the State, or that part of the State; and • the regulations under the Act provide that section 100B of the Act applies to the State, or that part of

	the State.
operating expenditure	The sum of operation expenditure, maintenance expenditure and administration expenditure.
operation expenditure	Expenditure associated with rural water service delivery including activities such as water ordering, planning delivery, meter reading, pumping costs, monitoring and operating assets
regulated charge	A charge to which the water infrastructure charge rules (section 91(1) (a) (b) and (d) of the Act) apply.
water access entitlement	A perpetual or ongoing entitlement, by or under a law of a state, to exclusive access to a share of the water resources of a water resource plan area.
Water Act	The Water Act 2007 (Cth).
water service infrastructure	Infrastructure for the storage, delivery or drainage of water.

1. Introduction

The Water Charge (Infrastructure) Rules 2010 (WCIR) relate to water infrastructure fees and charges levied by bulk water and irrigation infrastructure operators in the Murray-Darling Basin.

Under Part 6 of the WCIR the ACCC or an accredited state agency will be responsible for approving or determining the regulated charges levied by non-member operators that provide services in relation to at least 250GL of water access entitlements (Part 6 operators).[1]

This guide provides details on the recommended contents of a pricing application to be submitted by a Part 6 operator to the ACCC where the ACCC is the regulator.

Where a regulator is accredited by the ACCC to undertake price approvals or determinations under the WCIR, it may provide businesses with its own guidance material on information to be included in a pricing application. Alternatively, it can provide regulated businesses with this guide.

The document is structured as follows:

- **Chapter 2** discusses the purpose of a pricing application
- **Chapter 3** outlines the scope of what should be included in a pricing application
- **Appendix A** lists the pricing principles for price approvals and determinations under Part 6 of the WCIR

Further guidance about the ACCC's approach to approving or determining charges is provided in the ACCC publication *Pricing principles for price approvals or determinations under the water charge (infrastructure) rules.* It is also proposed that accredited regulators will be required to follow these principles as a condition of accreditation.

[1] If a state agency is accredited it will also be responsible for price approvals and determinations under Part 7 of the WCIR. Price approvals and determinations under Part 7 of the WCIR apply to member owned operators that provide services in relation to at least 10GL of entitlement and who pay a distribution to all member customers.

2. Background

Part 6 of the WCIR applies to non–member owned operators that provide services in relation to more than 250 GL of entitlement within the Murray-Darling Basin (MDB).[2]

Under Part 6 of the WCIR, a regulator will be responsible for approving or determining the maximum regulated charges that Part 6 operators may charge. Part 6 outlines:

- a price approval or determination process being undertaken prior to the commencement of the regulatory period to approve or determine maximum charges for the first year of the regulatory period and an indicative price path for each subsequent year of the regulatory period—as prescribed under Division 2 of Part 6
- an annual update of these maximum charges, in light of any updated information on demand or consumption forecasts, for each year of a regulatory period, excluding the first year—as prescribed under Division 3 of Part 6
- a provision for reopening a determination within a regulatory period–as prescribed under Division 4 of Part 6.

Under Part 6 of the WCIR the regulator will either be the ACCC or an accredited state agency. This document sets out the recommended contents of a pricing application to be submitted by Part 6 operators prior to the start of a new regulatory period where the ACCC is the regulator.

Purpose of a pricing application

A pricing application serves two purposes:

- Firstly, information in a pricing application will be a primary source of information for the ACCC in assessing whether to approve or determine regulated charges.
- Secondly, information in a pricing application is a means for operators to communicate with customers on what its proposed regulated charges should be over the forthcoming regulatory period and why the operator is proposing these charges.

Therefore a pricing application should be sufficiently clear and detailed to enable the ACCC to assess the relative merits of the proposed regulated charges and the underlying costs on which proposed charges are based. The application should aim to build a persuasive case for the ACCC on why expenditure is needed, justification for the expenditure proposed, and justification for the operator's proposed tariffs. The ACCC will approve charges in a pricing application if it is satisfied that those charges meet the relevant criteria under the WCIR. Where the ACCC is not satisfied of the above, it must determine charges that will satisfy these conditions.

[2] Or within a state where that state has chosen to have the Water Act apply in respect of all of non-urban water in its state. See Water Act Part 4A.

Operators should also note that in approving or determining regulated charges under the WCIR, the ACCC must have regard to whether the regulated charges would contribute to achieving the Basin water charging objectives and principles set out in Schedule 2 of the Water Act. One of these principles is to achieve pricing transparency in respect of water storage and delivery in irrigation systems. Therefore an operator should also include information in a pricing application that would enable a customer to understand the charges the operator is proposing, the revenue likely to be collected from these charges, how this revenue funds expenditure on infrastructure services over the regulatory period and the factors that ultimately contribute to this expenditure.

Because a pricing application has these two purposes, businesses are encouraged to work with the ACCC, customers and other stakeholders in developing a pricing application. This will help a business to further develop and provide information in its pricing application that meets the ACCC's requirements.

Prior to lodging a pricing application the ACCC also expects Part 6 operators to seek input from customers on matters to be included in its price application. This includes:

- price and service trade-offs
- investment decisions
- proposed tariffs.

Details of consultation with customers must be provided in a pricing application, and, in accordance with the pricing principles, consultation with customers will be taken into account by a regulator in approving or determining charges (see Appendix A).

When should an application be provided to the ACCC?

Under rule 30(1) of the WCIR, a regulator must, within 13 months after receiving a pricing application, approve or determine the regulated charges set out in the application.[3] Prior to making a final decision on charges, the regulator must publicly issue a draft decision, and seek submissions on that decision.

When the ACCC is a regulator under Part 6 of the WCIR, to reduce the risk that new regulated charges are not approved or determined by the start of the regulatory period to which the pricing application relates, it requests the completed pricing application be submitted **at least** 14 months prior to when a new regulatory period begins. At a time close to the commencement of a review the ACCC will provide specific guidance to each regulated business on the exact date it requests an application be provided, along with indicative dates by which the ACCC expects to make its draft and final decision.

A regulator may also write to the operator requesting the operator provide further information relating to the application within a period specified in the notice. If information is not provided within the time specified in the request the regulator can provide a written notice to the operator requesting further information. The assessment of the application will only restart once the information has been provided to the regulator.

[3] [3] A regulator may at its discretion take less than thirteen months to approve or determine charges.

Further information

Revenue model

As an attachment to the application where the ACCC is the regulator, a Part 6 operator is also required to complete information in a Microsoft Excel spreadsheet model provided by the ACCC. Cost inputs entered by the operator into spreadsheets will feed into a model that will calculate the revenue that would be needed to recover these costs. This can be used to compare against the revenue that would be recovered from charges proposed by the operator. The spreadsheets also include relevant data from previous price determinations made by state regulators. A customised spreadsheet model will be provided to each Part 6 operator for comment and the ACCC will consider all comments before each model is finalised.

Quality assurance

With an application, a Part 6 operator should provide independent quality assurance (for instance, by an auditor) of the financial information presented in a pricing application including all attachments. The independent assessor should:

- check the arithmetic accuracy of all financial information submitted as part of a pricing application
- reconcile all historical financial information against audited statutory financial accounts.

Further information

Further information may be provided as attachments to the main body of an application.

During the review, the ACCC may request further information relating to an application. If seeking further information the ACCC will write to a Part 6 operator requesting the further information be provided within a period specified in the notice.

Further guidance

This guide should also be read in conjunction with the pricing principles for price approvals or determinations under the water charge (infrastructure) rules. As some of these principles are particularly important when an application is prepared they are referred to within the body of this document. A full version of the principles is provided in Appendix A of this document. For further information about the pricing principles including the rationale behind the principles, consult the ACCC document *Pricing principles for price approvals or determinations under the water charge (infrastructure) rules*.[4]

[4]. The pricing principles may be revised from time to time to reflect changes in market conditions or new regulatory approaches. In making any substantive changes to the principles, the ACCC will seek the views of stakeholders, including regulated businesses and relevant state regulators. The ACCC will comprehensively review all pricing principles after 1 July 2014.

3. Scope of a pricing application

This section outlines the detail the ACCC expects to be included in a pricing application. Details expected in a pricing application include:

- a summary of application
- a summary of operations
- consultation undertaken in preparing the application
- proposed regulated charges
- obligations and projected service outcomes
- details of historical and proposed operating expenditure
- details of historical and proposed capital expenditure
- proposed rate of return
- details of renewals annuities (where applicable)
- forecast taxation payments
- proposed adjustments to regulated revenues
- detail of revenue required from regulated charges including detail of:
    - the rationale for the approach to tariff setting
    - the methodologies for determining demand/consumption forecasts
    - cost allocation methodologies.

Further details on these elements are provided below. It is includes the requirements referred to under Schedule 1 of the WCIR.

The format of the application in this section is indicative of a logical structure for a pricing application and should be used as a guide. A Part 6 operator may wish to alter the structure of its pricing application where it considers that information would be more logically presented using a different structure.

A. Main body of pricing application

I. Summary of application

The opening section of the application should summarise:

- the purpose of the application
- the charges for which the operator is seeking approval for in each year of the regulatory period
- the proposed changes in regulated charges compared to the current regulatory period
- a summary of the total revenue required from regulated charges in each year over the regulatory period including how this is split between the different 'building blocks' (i.e. operating expenditure, regulatory depreciation, return on capital, tax, other adjustments).
- a summary of the main factors expected to influence charges over the forthcoming regulatory period.

The opening section should also provide an outline of the contents of the remainder of the pricing application.

II. Summary of operations

Provide background information on the different infrastructure services for which the application relates to. This should include:

- a brief description of the geographical area where water infrastructure services are provided
- detail on the water infrastructure services provided
- a summary of customer numbers for each infrastructure service and the water access entitlements held by these customers
- a summary of the bulk water, irrigation infrastructure and other water infrastructure assets owned or operated.

Infrastructure services defined in a pricing application should be consistent with the National Water Commission’s definitions of rural water services current at the time an application is made.

III. Consultation undertaken in preparing this application

Clearly outline the consultation that has been undertaken with customers and other stakeholders in preparing this plan.

Information on customer consultation should include:

- a statement of the operator’s consultation policy
- the objectives of the consultation undertaken
- the steps involved in the consultation process, and the expected deliverables in each step
- key dates
- a summary of feedback received from customers and other stakeholders during consultation processes
- explanation of how feedback in consultation has been addressed in this pricing application.

IV. Proposed regulated charges

List the proposed regulated charges for which approval is being sought.

Regulated charges under the WCIR include:

- charges payable to an irrigation infrastructure operator for:
    - access to the operator’s irrigation network (or services provided in relation to that access)
    - changing access to the operator’s irrigation network (or services provided in relation to that access).

- bulk water charges being charged for bulk water services including charges imposed on private diverters
- fees or charges (that do not relate to an irrigation network or urban water supply network or are not bulk water charges) payable to infrastructure operators for:

    - access to the operator's water service infrastructure or services provided in relation to that access
    - changing access to water service infrastructure or services provided in relation to that access, including fees or charges
    - terminating access to water service infrastructure or services provided in relation to that access, including charges payable to a bulk water supplier for terminating access to a bulk water service
    - surrendering the operator a right to delivery of water through the operator's water service infrastructure.

When listing proposed regulated charges, provide sufficient details to enable the regulator to understand who the charge would be levied on and the circumstances in which the charge would be levied. Such information must include:

- the proposed fixed and variable components of multi-part tariffs, including the basis of the charge—e.g. ML of entitlement, type of entitlement, hectares, number or type of outlets
- proposed charges for market segments where different rates would apply to
    - different geographical regions—e.g. valley/district
    - segmentation by type of water right—e.g. stock and domestic/irrigation; type of water—e.g. high/general security.
- proposed differentials applying to
    - different infrastructure—e.g. pumped and piped/gravity fed channels/combination of both
    - different time of delivery—e.g. peak/off peak usage
    - different customer groups—e.g. with enhanced delivery or drainage service
    - discounts and surcharges that may apply and the circumstances in which they apply.

In providing detail on proposed regulated charges the application should also:

- compare proposed regulated charges in the forthcoming regulatory period to charges faced by customers in the current regulatory period.
- identify the regulated charges that are significantly different to charges faced by customers over the current regulatory period
- identify the main reasons why it is proposed that charges change from charges levied in the current regulatory period.

As an attachment, also list proposed charges/fees in the forthcoming regulatory period which are not considered to be regulated charges

After an application has been submitted the ACCC may seek further information on proposed charges and fees.

V. Obligations, and projected service standards

In helping the ACCC to understand the outcomes that the operator plans to deliver over the regulatory period, outline:

- the regulatory, legislative and other obligations that have been or are forecast to be imposed on the business
- the projected service standards over the regulatory period.

Legislative and other government obligations

Regulatory, legislative and other obligations may include obligations relating to the operator's operating licence, to meet environmental requirements or for some other reason. While service standards or outcomes may be one such obligation, these should be provided in a separate section of the application, as set out below.

For obligations that have been imposed either through legislation or by a government clearly explain:

- the obligation that has either been imposed on the operator, or is likely to be imposed on the operator
- the relevant Act, legislative instrument and licence where the obligation has been applied or is likely to be imposed on the operator.

Where an obligation will be new or is forecast to change in the forthcoming regulatory period outline:

- the different options (if any) the operator has considered in how it will meet this obligation
- where relevant, the process undertaken to decide how the operator will meet the obligation, including consultation undertaken
- the proposed action(s) to meet the obligation
- the expected outcomes from undertaking the action(s)
- the expected date of the new or changed obligation.

Projected service standards

For each service standard that applies, or is forecast to apply in the forthcoming regulatory period (such as minimum standards for key performance indicators or performance targets), provide the following information:

- clear definition of service standard
- unit of measurement for the service standard

- how the service standard is calculated
- how performance against the service standard will be reported to customers
- the targeted performance level
- historical performance against the service standard (where recorded).

Where a service standard will be new, or is forecast to change in the forthcoming regulatory period outline:

- the different options (if any) the operator has considered in how it will meet this service standard
- where relevant, the process undertaken to decide how the operator will meet the service standard, including consultation undertaken
- the proposed action(s) to meet the obligation
- the expected outcomes from undertaking the action(s).

VI. Operating expenditure

Before approving or determining regulated charges the ACCC will need to be satisfied that proposed operating expenditure over the forthcoming regulatory period is prudent and efficient.

In approving or determining regulated charges the ACCC has published pricing principles that provide detail about what a regulator will need to do in making this assessment of proposed operating expenditure. For information the pricing principles for operating expenditure are outlined below.

Box A – Pricing principles for operating expenditure

In making an assessment of the prudent and efficient operating expenditure for the next regulatory period, the regulator must assess:

- the prudency and efficiency of operating expenditure in the previous regulatory period
- the reasons and evidence supporting changes to service standards in the next regulatory period
- the reasons and evidence supporting changes to operating expenditure in the next regulatory period
- reasonable productivity improvements in providing services over the next regulatory period.

Where relevant, a regulator must compare and take into account operating expenditure of similar businesses.

Forecasts must be based on reasonable assumptions of the efficient costs likely to be incurred in this period.

For the ACCC to be in a position to apply the pricing principles the pricing application must contain sufficient information about operating expenditure from the current regulatory period, the forthcoming regulatory period, and how those forecasts have been formulated.

This is to include the following information:

Operating expenditure in current regulatory period

Summarise and provide data on:

- the operating expenditure approved for the current regulatory period
- actual operating expenditure for years completed in the current regulatory period
- for the years not yet completed in the current regulatory period, any updated estimates of operating expenditure.

Where there are changes between the operating expenditure approved for the current regulatory period and the actual operating expenditure or updated estimates of operating expenditure, explain:

- the reason for the change
- whether this is expected to be a recurrent or a one-off variation
- the factors that generally influenced the variation.

Proposed operating expenditure

Summarise and provide data on forecast operating expenditure for each year of the forthcoming regulatory period. This should include the following information:

Summary

Summarise the total operating expenditure required in each year of the regulatory period.

Provide information that explains how this is separated between different categories of operating expenditure (e.g. operations, maintenance, corporate) and separated between different segments of the business (e.g. irrigation, bulk water, stock and domestic) and different geographic regions. Provide tables where appropriate.

Cost drivers

Identify the main cost drivers likely to affect operating expenditure in the forthcoming regulatory period. In general, cost drivers for operating expenditure are likely to relate to one or more of the following:

- business-as-usual operating expenditure
- changes in input costs
- changes in demand for infrastructure services

- operating expenditure to deliver higher levels of service for customers
- operating expenditure to meet regulatory, legislative or other obligations determined by government
- intermittent asset maintenance requirements.

The application should explain changes in operating expenditure in reference to one or more cost drivers(s), any evidence to support the existence of the cost driver and any evidence to support that expenditure including the level of expenditure.[5]

Data on cost drivers can be provided for the whole business, for different business operations or for particular geographic areas in which the business operates. Disaggregated data on cost drivers is recommended where proposed changes to operating expenditure are material and/or those changes disproportionately affect particular customers in comparison to other customers.

Productivity improvements

Identify the productivity improvements reflected in the operating expenditure forecasts over the regulatory period.

Further information

Data on forecast operating expenditure should be entered in the templates provided by the ACCC.

Further data on proposed operating expenditure separated according to different accounting cost categories, and allocated to different business segments and geographic regions should be provided in attachments to the application to assist the ACCC in further understanding the proposed operating expenditure.

VII. Capital expenditure

The ACCC has also published pricing principles that provide detail about what a regulator will need to do in making an assessment of proposed capital expenditure. The pricing principles for capital expenditure are outlined below.

Box B - Pricing principles for capital expenditure

In making an assessment of the prudent and efficient capital expenditure for the next regulatory period, the regulator must assess:

- the prudency and efficiency of capital expenditure in the previous regulatory period (where relevant to proposed capital expenditure in the next regulatory period)
- the reasons and evidence supporting the commencement of

[5] If the cost driver is changed service standards and information explaining changes to service standards has been provided in a previous section of the application then cross-reference that section of the application and quantify the actual or forecast impact of the change on costs.

new major capital expenditure projects in the next regulatory period, including whether such projects are consistent with efficient long term expenditure on infrastructure services.

- the reasons and evidence supporting levels of capital expenditure in the next regulatory period
- whether the timeframe for delivering the proposed capital expenditure program is reasonable, having regard to the operator's delivery of major projects in the past
- whether the asset management and planning framework of the operator reflects best practice.

Forecasts must be based on reasonable assumptions of the efficient costs likely to be incurred across the regulatory period.

Subject to confidentiality, any external review of an operator's proposed capital expenditure must be made public on the regulator's website.

As with the assessment of proposed operating expenditure, for the ACCC to be in a position to apply the pricing principles the pricing application must contain sufficient information about capital expenditure from the current regulatory period, the forthcoming regulatory period, and how those estimates and forecasts have been formed. In general, the ACCC expects that more detailed information is provided where there is significant new capital expenditure.

The application is to include the following information:

Capitalisation policy

Provide details of how it has been determined whether expenditure is capital expenditure or operating expenditure.

Asset management and planning approach

Summarise relevant asset management and planning policies and practices. This may include detail of the following:

- how current asset performance is assessed. This may include assessments of physical condition, utilisation, functionality or financial performance
- strategies or plans for determining operational and maintenance needs over the life of major assets.

As an attachment to the application, provide detail of relevant policies and practices.

Historical capex

Summarise and provide data on:

- the capital expenditure approved by the relevant state regulator for the current regulatory period

- actual capital expenditure for years completed in the current regulatory period
- for the years not yet completed in the current regulatory period, any updates in estimates since the relevant state regulator's determination for the current regulatory period.[6]

This data must also be provided within the spreadsheet model provided by the ACCC.

Where there are changes between the capital expenditure that was approved by the relevant state regulator and the actual capital expenditure or updated estimates of capital expenditure, explain:

- the reason for the change
- the factors that generally influenced the variation.

Also, explain where there has been a change in timelines to the capital expenditure approved by the relevant state regulator for the current regulatory period and the reasons for this variation.

Proposed capital expenditure

Summarise the total capital expenditure required in each year of the regulatory period.

Major projects

A major project is considered to be one for which total expenditure on the project over its life is expected to exceed $2m or 5% of the annual revenue to be recovered through regulated charges – whichever is the lesser amount.

Where a major project is expected to continue into or commence in the forthcoming regulatory period, provide details about the project.

Information provided is to include the following:

Background

Include:

- a description of the works (include diagrams where appropriate)
- the location of the works (include maps where appropriate)
- the infrastructure services affected by the works
- the type of customers affected
- project milestones including the expected commencement (if not yet started) and completion dates of the plans.

[6] During the assessment of a pricing application the ACCC will request audited financial information on actual capital expenditure, government expenditure for capital expenditure, customer contributions for capital expenditure, and asset disposals from the penultimate year of the current regulatory year.

Cost drivers

Provide details on why the expenditure is occurring.

Broadly, capital expenditure will be expected to occur for at least one of the following reasons:

- to meet increased growth in demand (either by increasing the capacity of existing assets or constructing new assets)
- to address declining demand (either by reconfiguring, decommissioning, or rationalising existing assets)
- to maintain existing service levels or to deliver higher levels of service for customers
- to meet regulatory, legislative or other obligations determined by government.

Where the works are planned to address changing demand, provide details about the expected magnitude and location of change in demand.

Where the works refer to levels of service, or regulatory or legislative obligations, provide details about the specific levels of service or obligations in question.

Estimated expenditure

Include details about the estimated expenditure for each project in question.

Estimates are to include:

- total expected expenditure over the life of the project (including for years beyond the forthcoming regulatory period)
- estimated expenditure in each year of the life of the project including completed expenditure (where relevant).

Evidence supporting the works

For all major projects provide details of evidence that will help support:

- the rationale for undertaking the works
- the estimated expenditure on the works
- the prudency and efficiency of the estimated expenditure
- the timing for the works.

Included in the discussion should be a statement on how the major project is aligned with the operator's long term investment plans.

Evidence for undertaking the works may include advice from consultants. Where the evidence refers to advice gathered from consultants, the advice may be attached to the application.

Risks

Provide details about the main risks to the projects identified above and an assessment of the likelihood of the risks affecting the project.

Risks may affect whether the project goes ahead, the timing of the project or the costs of the project.

Further information

Data on actual capital expenditure in the current regulatory period and forecast capital expenditure in the forthcoming regulatory period should be provided in the templates provided by the ACCC.

Further data on historical and proposed capital expenditure separated according to different accounting cost categories, and allocated to different business segments and geographic regions should be provided in attachments to the application to assist the ACCC in further understanding the capital expenditure that has been proposed.

To help understand the proposed capital expenditure forecasts, the ACCC may seek further information related to the capital expenditure forecasts during its review. This may include information on more minor capital projects and works.

VIII. Regulatory asset base

RAB roll-forward from current regulatory period

Under the rules if a Part 6 operator has had its RAB set by an agency of a state under a law of the state in the regulatory period preceding the commencement of the initial regulatory period under Part 6, this value must form the opening RAB value for the purposes of the initial approval or determination process under Part 6.

Under Schedule 2(1) the RAB for the first regulatory period must be rolled forward in accordance with the formula {(A-B)+C}-(D+E) where:

- A is the value of the operator’s assets that were used for the preceding period.
- B is the value of those assets that were not used by the operator to provide infrastructure services during the preceding period and any assets contributed by customers or government.
- C is the actual (or, in the case of the last year of the preceding period, forecast) capital expenditure on assets used by the operator to provide infrastructure services (net of actual customer and government capital expenditure contributions) in respect of each year of the preceding period.

- D is the regulatory depreciation in respect of assets used to provide infrastructure services (as determined for each year of the preceding period)
- E is the actual (or, in the case of the last year of the preceding period, forecast) revenue received by the operator from disposal of assets used to provide infrastructure services in the preceding period.

Detailed quantitative information on the above is to be provided in the spreadsheet model provided by the ACCC.

The application should:

- provide a table of the RAB roll-forward summarising the calculation from the spreadsheet model
- explain what the asset disposals, customer contributions and government contributions refer to
- explain the rationale for the selection of useful lives for capital expenditure commencing in the forthcoming regulatory period
- explain the rationale for the depreciation profile (where it is not straight line).

Forecast RAB for forthcoming regulatory period

The spreadsheet model will also calculate the RAB for the forthcoming regulatory period.

For that period, the application must also:

- provide a table of the RAB roll-forward calculation from the spreadsheet model
- explain the forecast contributions from customers and government and the assumptions underpinning those forecasts
- explain the forecast proceeds from asset disposals and the nature and type of assets anticipated to be sold.

IX. Rate of return

Summarise how the proposed rate of return has been calculated.

The pricing principles prescribe the approach and/or parameters to be used in setting the weighted average cost of capital. The estimates for some parameters (e.g. risk free rate, debt risk premium) depend on market conditions at the time prices are determined. To assist with preparing an application, the ACCC can provide an operator with further guidance on what those parameters may be. Any further guidance at that time will be indicative only.

X. Renewals annuities

Where expenditure is funded through an annuity, details should be provided in the application to enable the ACCC to apply the pricing principles relating to assessment of renewals annuities (See Box C).

Box C – Pricing principles for renewals annuities

Where a renewals annuity is used, the regulator must be satisfied that it:

- provides sufficient revenue to fund all required expenditure
- reflects prudent and efficient expenditure forecasts
- the discount rate used to calculate the annuity is reasonable
- is set across a long term planning horizon beyond the period to which the application applies and
- that the length of the annuity is determined by the capital expenditure program so that all material expenditure is captured.

In the pricing application, for each annuity used by the operator explain:

- the rationale for using an annuity for financing expenditure
- the assets for which the annuity is for
- the asset life assumptions for assets funded through the annuity
- the term of the annuity
- the profile of the expected payments into the annuity and expenditure from the annuity over its term
- the estimated opening and closing balance of the annuity in each year of the current regulatory period
- the forecast opening and closing balance of the annuity in each year of the forthcoming regulatory period
- estimated payments on infrastructure out of the annuity in each year of the regulatory period
- the purpose of the payments out of the annuity in each year of the regulatory period
- expected annual interest payments into the annuity
- other annual transactions from the annuity over the period of the regulatory period.

XI. Tax

Where the operator requires revenue to recover the costs of forecast tax obligations in the forthcoming regulatory period, provide details of how this has been calculated.

Where there are no forecast tax obligations in the forthcoming regulatory period explain the reasons why.

Enter relevant data into the templates provided by the ACCC including any tax losses proposed to be carried forward from the current regulatory period to the forthcoming regulatory period.

XII. Proposed adjustments to regulated revenues

The core ‘building blocks’ of an operator’s regulated revenues are:

- operating expenditure
- return on capital
- regulatory depreciation
- tax.

However there is the ability for the regulator to make other adjustments to regulated revenues that would increase or decrease the revenue required from regulated charges over the forthcoming regulatory period. Operators should provide information in an application of any proposed adjustments. Adjustments may include the following:

Shortfalls or windfalls from forecasting errors in the current regulatory period

In transitioning to the new regulatory framework under the WCIR, there may be shortfalls or windfalls arising from over-forecasting or under-forecasting in the current state regulatory period. A regulator can take shortfall losses or windfall gains into account when determining revenue requirements for the first regulatory period under the WCIR.

If proposing to carry forward shortfalls or windfalls from the current regulatory period to the forthcoming regulatory period, specify:

- the amount of the revenue shortfall or windfall sought to be carried forward
- the reasons for seeking the carry forward of the balance
- details on how the shortfall or windfall has been calculated.

Revenue from termination fees

Under the pricing principles, the regulator must also take into account the revenue already received from termination fees in determining the revenue required from regulated charges. Therefore, this part of the application should detail how the revenue from regulated charges has been adjusted to reflect revenue received from termination fees.

In this section also outline how customers have been consulted about the proposal for determining how revenue received from termination fees will be reflected in regulated charges.

Balances from annuities or other accounts

Where annuities or other accounts are no longer used by operators to fund infrastructure services, but there is still a positive or negative balance from such an account, provide details of the account including:

- the estimated opening balance of the account at the start of the current regulatory period
- the amount or the balance used to increase or decrease the revenue required from regulated charges in the current regulatory period
- the proposed amount used to increase or decrease the revenue required from regulated charges in the forthcoming regulatory period
- the forecast closing balance of the account.

Revenue from other sources

Summarise all other revenues that relate to the expenditure forecasts in the application that will not be collected through regulated revenues. This may include revenue collected from non-regulated charges, or estimated revenue to be received from government or non-regulated contributions from customers for operating expenditure or other non-capital items.[7]

XIII. Revenue required from regulated charges

Provide details of the revenue estimated to be recovered from each proposed regulated charge in each regulatory year. This information is to be provided in a table and will also need to be provided in the templates provided by the ACCC.

Tariff structures

Provide details on how proposed regulated charges have been set including:

- a description of the different tariff structures used across the business
- the reasons for adopting the approach to determining tariff structures
- where tariff structures are different from the current regulatory period, the reasons for proposing a change, and how customers have been consulted in determining what tariff structures should apply.

When providing detail about tariff structures, note that the ACCC will assess tariff structures against the pricing principles (Box D).

[7] Note that government and customer contributions for capital expenditure will be subtracted from the RAB.

Box D – Pricing principles for tariff structures

Tariff structures should:

- promote the economically efficient use of water infrastructure assets
- ensure sufficient revenue streams to allow efficient delivery of the required services
- give effect to the principles of user pays in respect of water storage and delivery in irrigation systems
- achieve pricing transparency
- facilitate efficient water use and efficient functioning of water markets

Approach to cost allocation

In further explaining the methodology for determining proposed charges, the application will need to explain the rationale for how costs have been allocated to be recovered by different regulated charges. That is, the reader of the application should be able to draw the link between the information provided in the application on the 'building blocks' of the business and how it has been determined these 'building blocks' are allocated across the regulated business and to different tariffs. The pricing principles outline the information on cost allocation methodologies that a regulator must be provided with in order to be able to approve or determine regulated charges (see Box E).

Box E – Pricing principles for cost allocation

Charges are to be approved or determined on the basis of a cost allocation methodology that:

- identifies which costs arise from providing infrastructure services (to which regulated charges apply) and which costs arise from other activities undertaken by the operator
- attributes direct costs to the service to which they relate and not more than once to any category of service
- uses an appropriate allocator when a causal allocator for shared costs can be identified
- only uses a non-causal allocator for shared costs where those costs are immaterial or no causal relationship could be established without undue cost and effort
- allocates shared costs such that the full amount of those costs, no more or no less, is allocated to the services to which it relates.

The same cost must not be allocated more than once in any instance.

This section should also outline the steps taken by the operator to 'ring-fence' services for which there is no charge or where the charge is not regulated under the WCIR.

Further supporting information on the allocation of costs, such as regulatory accounting cost codes for business segments, may be provided in an attachment but is not required in the application. If cost allocation methodologies are unclear, the ACCC will request more detailed information on how costs have been allocated across the business.

Forecast demand and consumption

The pricing principles require a regulator to assess the demand/consumption forecasts. The principles are outlined below in Box F.

Box F - Pricing principles on forecast demand and consumption

An assessment of a Part 6 operator's demand or consumption forecasts is to involve an assessment of whether the demand or consumption forecasts:

- are based on appropriate forecasting methodology
- are based on reasonable assumptions about the key drivers of demand, including:
    - supply restrictions
    - environmental conditions, including inflows and the availability of water
    - commodities, including the treatment of water as a derived demand
    - any elasticity assumptions
    - demographic impacts, where appropriate.
- utilise the best available information, including historical data that can identify trends in demand
- take account of current demand and economic conditions.

The regulator may engage an independent consultant to assist in determining the above. All reports from consultants should be made public, subject to confidentiality.

To enable the ACCC to carry out these functions, the application must provide sufficient information about demand/consumption forecasts used for each regulated charge. This must include detail describing the methodologies used for calculating each regulated charge along with tables that summarise the forecasts used to calculate revenue for each regulated charge.

When providing information on key drivers of demand, it should be noted that the list referred to in the pricing principles is not intended to be an exhaustive list. Demand and consumption could be influenced by other factors - for instance infrastructure modernisation and other water savings measures implemented by an operator and/or customers.

Any further relevant information supporting the forecasts may be provided as an attachment.

Form of price control

The pricing principles allow for flexibility in choosing the form of price control. State the form of price control that the operator would like to apply, and the reasons for making this proposal. The ACCC will assess the proposal during a price review.

B. Attachments

Attachments to the pricing application should include:

- completed spreadsheet model
- data on historical and proposed operating and capital expenditure separated according to business segments and geographic regions
- list of non-regulated charges
- statement verifying there has been independent quality assurance of financial information in an application.

Attachments may also include the following as supporting information for the pricing application,:

- models/methodologies for forecasting costs
- models/methodologies for allocating costs
- models/methodologies for forecasting demand/consumption
- consultant or other expert reports that supports detail in the application
- any other evidence relevant to the application.

Appendix A - Pricing principles for Part 6 approvals or determinations

This version of the pricing principles is current at July 2011. The pricing principles may be revised from time to time to reflect changes in market conditions or new regulatory approaches.

Valuation of the opening Regulatory Asset Base (RAB)

- If a Part 6 operator has had its RAB set by an agency of a state under a law of the state in the regulatory period preceding the commencement of the initial regulatory period under Part 6, this value must form the opening RAB value for the purposes of the initial approval or determination process under Part 6.
- Where a RAB value has not been previously set by an agency of a state under a law of the state, the RAB must be determined by applying a recognised valuation methodology. The RAB may only include assets used to provide infrastructure services and may not include any assets:
  - gifted by government or another third party, with no expectation of a rate of return on those assets
  - funded by customers through charges, a renewals annuity or otherwise
  - funded through other customer contributions.
- The regulator must ensure that the initial RAB value does not result in price shocks.

Roll forward of the RAB

- The RAB must be rolled forward as per Schedule 2 of the rules.

Rate of return

- The cost of capital is to be calculated on the basis of a WACC determined in accordance with the following formula:

$$WACC = k_e \frac{E}{V} + k_d \frac{D}{V}$$

- The cost of equity is to be estimated using the domestic CAPM based on the Officer model.
- The cost of equity is to be calculated using a MRP of 6 per cent.
- The risk free rate is to be based on the yield of a 10 year CGS bond, using an averaging period of between 10-40 business day period commencing as close as practically possible to the start of the regulatory period.
- The cost of equity is to be calculated using an equity beta of 0.7.

- The benchmark DRP is to be estimated on the basis of a benchmark gearing level of 60:40 debt to equity on the yields of BBB+ rated corporate bonds with 10 year maturity.

Assessment of operating expenditure

- In making an assessment of the prudent and efficient operating expenditure for the next regulatory period, the regulator must assess:
  - the prudency and efficiency of operating expenditure in the previous regulatory period
  - the reasons and evidence supporting changes to service standards in the next regulatory period
  - the reasons and evidence supporting changes to operating expenditure in the next regulatory period
  - reasonable productivity improvements in providing services over the next regulatory period
- Where relevant, a regulator must compare and take into account operating expenditure of similar businesses.
- Forecasts must be based on reasonable assumptions of the efficient costs likely to be incurred in this period.

Assessment of capital expenditure

- In making an assessment of the prudent and efficient capital expenditure for the next regulatory period, the regulator must assess:
  - the prudency and efficiency of capital expenditure in the previous regulatory period (where relevant to proposed capital expenditure in the next regulatory period)
  - the reasons and evidence supporting the commencement of new major capital expenditure projects in the next regulatory period, including whether such projects are consistent with efficient long term expenditure on infrastructure services.
  - the reasons and evidence supporting levels of capital expenditure in the next regulatory period
  - whether the timeframe for delivering the proposed capital expenditure program is reasonable, having regard to the operator’s delivery of major projects in the past
  - whether the asset management and planning framework of the operator reflects best practice
- Forecasts must be based on reasonable assumptions of the efficient costs likely to be incurred in this period.
- Subject to confidentiality, external review of an operator’s proposed capital expenditure must be made public on the regulator’s website.

Debt raising costs

- The regulator must treat any forecast debt raising costs as operating expenditure.

Depreciation

- Fixed assets should be depreciated using a straight line methodology. However, the regulator or the operator may adopt a different approach to depreciation where an operator can justify departure from this method or where it is appropriate for the regulator to do so. Where a different approach is used, the net present value to the business must be the same as under a straight line methodology.
- Depreciation for an asset must only be recovered once that asset is providing infrastructure services.

Taxation

- In estimating the annual taxation building block, the regulator must estimate the annual actual corporate income taxation to be paid by the operator less the imputation credits that would be received by a hypothetical private investor in the operator.
- In estimating the value of imputation credits the regulator must multiply the annual estimated corporate income tax bill of the operator by an imputation factor (gamma).
- If required, the imputation factor will be determined by the ACCC.

Renewals annuities

- Where a renewals annuity is used, the regulator must be satisfied that it:
  - provides sufficient revenue to fund all required expenditure
  - reflects prudent and efficient expenditure forecasts
  - the discount rate used to calculate the annuity is reasonable
  - is set across a long term planning horizon beyond the period to which the application applies and that the length of the annuity is determined by the capital expenditure program so that all material expenditure is captured.

Cost allocation principles

- Charges are to be approved or determined on the basis of a cost allocation methodology that:
  - identifies which costs arise from providing infrastructure services (to which regulated charges apply) and which costs arise from other activities undertaken by the operator
  - attributes direct costs to the service to which they relate and not more than once to any category of service

  - uses an appropriate allocator when a causal allocator for shared costs can be identified
  - only uses a non-causal allocator for shared costs where those costs are immaterial or no causal relationship could be established without undue cost and effort
  - allocates shared costs such that the full amount of those costs, no more or no less, is allocated to the services to which it relates.
- The same cost must not be allocated more than once in any instance.

Form of price control

- A regulator may apply any form of price control – subject to meeting the requirements of the Water Charge Infrastructure Rules 2010.

Tariff structures

- Tariff structures should:
  - promote the economically efficient use of water infrastructure assets
  - ensure sufficient revenue streams to allow efficient delivery of the required services
  - give effect to the principles of user pays in respect of water storage and delivery in irrigation systems
  - achieve pricing transparency
  - facilitate efficient water use and trade in water entitlements.

Revenue from termination fees

- The regulator must take into account the revenue already received by the operator from termination fees when determining the required revenue from regulated charges in the forthcoming regulatory period.
- The method for addressing revenue from termination fees must be transparent to customers and promote price stability.

Demand or consumption forecasts

- An assessment of a Part 6 operator's demand or consumption forecasts is to involve an assessment of whether the demand or consumption forecasts:
  - are based on appropriate forecasting methodology
  - are based on reasonable assumptions about the key drivers of demand, including:
    - supply restrictions
    - environmental conditions, including inflows and the availability of water

        - commodities, including the treatment of water as a derived demand
        - any elasticity assumptions
        - demographic impacts, where appropriate.
    - utilise the best available information, including historical data that can identify trends in demand
    - take account of current demand and economic conditions.
- The regulator may engage an independent consultant to assist in determining the above. All reports from consultants should be made public, subject to confidentiality.

Customer consultation

- The regulator must have regard to consultation undertaken by an operator in approving or determining regulated charge