



Australian
Competition &
Consumer
Commission

Water infrastructure charge rules

Advice to the Minister for Climate Change and Water

June 2009

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Abbreviations

ACCC	Australian Competition and Consumer Commission
Basin	Murray–Darling Basin
CIT	Central Irrigation Trust
COAG	Council of Australian Governments
Cwlth	Commonwealth
DWE	Department of Water and Energy (New South Wales)
DEWHA	Department of the Environment, Water, Heritage and the Arts
ESC	Essential Services Commission (Victoria)
ESCOSA	Essential Services Commission of South Australia
Gazette	<i>Commonwealth of Australia Government Notices Gazette</i>
GMW	Goulburn-Murray Water
GVIA	Gwydir Valley Irrigators Association Inc.
GWMWater	Grampians Wimmera Mallee Water
GL	gigalitre (1000 megalitres)
IIO	irrigation infrastructure operator
IPART	Independent Pricing and Regulatory Tribunal (New South Wales)
LMW	Lower Murray Water
MDB	Murray–Darling Basin
MDB Agreement	Murray–Darling Basin Agreement
MDB Authority	Murray–Darling Basin Authority
MHC	Murrumbidgee Horticulture Council Inc.
MI	Murrumbidgee Irrigation Limited
MIL	Murray Irrigation Limited
ML	megalitre (1 million litres)

MRFF	Macquarie River Food and Fibre
NCP	network consultation paper
NFF	National Farmers' Federation
NSP	network service plan
NSW	New South Wales
NSWIC	NSW Irrigators' Council
NWI	National Water Initiative
Qld	Queensland
RAB	regulatory asset base
RMW	River Murray Water
SA	South Australia
SA Water	South Australian Water Corporation
Water Act	<i>Water Act 2007</i> (Cwlth)
WACC	weighted average cost of capital
WMI	Western Murray Irrigation

Glossary

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

allocative efficiency is a situation in which resources are used to produce goods and services that provide the maximum benefit to society. An important condition for allocative efficiency is that prices for services reflect the value society places on the next best alternative use of the resources used to produce the service.

Basin state means the following:

- (a) New South Wales
- (b) Victoria
- (c) Queensland
- (d) South Australia
- (e) Australian Capital Territory.

Basin water resources means all water resources within, or beneath, the Murray–Darling Basin, but does not include:

- (a) water resources within, or beneath, the Murray–Darling Basin prescribed by the regulations for the purposes of this paragraph, or
- (b) groundwater that forms part of the Great Artesian Basin.

bulk water charge means a charge payable for the storage of water for, and the delivery of water to, any of the following:

- (a) infrastructure operators
- (b) other operators of reticulated water systems
- (c) other persons prescribed for the purposes of this paragraph.

distribution is a payment, or the declaration of a payment, to a member customer from its profits or reserves by a member owned operator.

draft advice Water infrastructure charge rules draft advice (April 2008)

draft rules Draft water charge (infrastructure) rules 2009

infrastructure operator	<p>is a person who owns or operates infrastructure for one or more of the following purposes:</p> <ul style="list-style-type: none"> (a) the storage of water (b) the delivery of water (c) the drainage of water <p>for the purpose of providing a service to another person.</p>
infrastructure service	means access, or a service provided in relation to access, to water service infrastructure and includes the storage, delivery, drainage and taking of water.
irrigation right	is a right that a person has against an operator to receive water, that is not a water access right or a water delivery right.
irrigation district	is an area or district supplied with water via an infrastructure supply network (channels, pipes and other structures) operated and maintained primarily to supply water for use within that district.
irrigation infrastructure operator	is an infrastructure operator that operates water service infrastructure for the purpose of delivering water for the primary purpose of being used for irrigation.
irrigator	is a person who receives water delivery services from an irrigation infrastructure operator. This may include a person who receives water for any purpose, such as stock and domestic.
member owned operator	is one for which the volume of water to which its customers are entitled in relation to a water access entitlement held by the operator is more than the total volume of water to which customers are otherwise entitled.
Murray–Darling Basin	<p>is the area falling within the boundary described in the dataset that:</p> <ul style="list-style-type: none"> (a) is titled ‘Murray–Darling Basin Boundary—Water Act 2007’ (b) has a dataset scale of 1:250 000 (c) specifies the boundary of the Murray–Darling Basin drainage division derived from the dataset titled ‘Australia’s River Basins 1997’ and is dated 30 June 1997 (d) is held by the Commonwealth.

National Water Initiative	means the intergovernmental agreement on a national water initiative between the Commonwealth of Australia and the governments of New South Wales, Victoria, Queensland, South Australia, Western Australia, Tasmania, the Australian Capital Territory and the Northern Territory (as amended from time to time).
non-member owned operator	is one for which the volume of water to which its customers are entitled in relation to a water access entitlement held by the operator is equal to or less than the total volume of water to which customers are otherwise entitled.
operator	is an infrastructure operator.
position paper	Water charge rules position paper (September 2008)
regulated charge	means a charge of a kind referred to in paragraph 91(1)(a), (b) or (d) of the Water Act but does not include: <ul style="list-style-type: none"> (a) a fee to which rule 13 of the <i>Water Market Rules 2009</i> applies or (b) a fee to which rule 6 or 8 of the <i>Water Charge (Termination Fees) Rules 2009</i> applies.
regulated water charges	are charges to which the water charge rules (s. 91, Division 1, Part 4 of the Water Act) can apply.
surface water	includes: <ul style="list-style-type: none"> (a) water in a watercourse, lake or wetland (b) any water flowing over or lying on land: <ul style="list-style-type: none"> i. after having precipitated naturally or ii. after having risen to the surface naturally from underground.
termination fee	means a fee levied by an irrigation infrastructure operator when a delivery entitlement is surrendered to the infrastructure operator to terminate any rights or obligations associated with that delivery entitlement (including any requirement to pay an access fee).
transformation	is the process by which an irrigator permanently transforms their entitlement to water in relation to an irrigation right against an operator into a water access entitlement held by the irrigator (or anybody else), thereby reducing the share component of the operator's water access entitlement.

upper bound pricing	<p>means the level at which, to avoid monopoly rents, a water business should not recover more than:</p> <ul style="list-style-type: none"> (a) the operational, maintenance and administrative costs, externalities, taxes or tax equivalent regimes (b) provision for the cost of asset consumption (c) provision for the cost of capital (calculated using a weighted average cost of capital).
volumetric charge	is a fee charged on the basis of the quantity of water delivered.
water access right	<p>is any right conferred by or under a law of a state to hold water from a water resource or to take water from a water resource. This includes stock and domestic rights, riparian rights, a water access entitlement, a water allocation and any other right relating to the taking or use of water prescribed by regulations made under the Water Act.</p>
water access entitlement	is 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 allocation	is the specific volume of water allocated to a water access entitlement in a given water accounting period.
water charge rules	are rules made by the Minister for Climate Change and Water under s. 92 of the Water Act that relate to regulated water charges.
water market rules	are the ‘Water Market Rules 2009’.
water delivery right	is a right to have water delivered by an operator.
water resource	<p>means:</p> <ul style="list-style-type: none"> (a) surface water or ground water or (b) a watercourse, lake, wetland or aquifer (whether or not it currently has water in it) <p>and includes all aspects of the water resource (including water, organisms and other components and ecosystems that contribute to the physical state and environmental value of the water resource).</p>

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Summary

The *Water Act 2007* (Cwlth) (the Water Act) creates new institutional and governance arrangements to address the sustainability and management of water resources in the Murray–Darling Basin (MDB). Among other things, the Water Act gives the Minister for Climate Change and Water (the minister) the role of making water charge rules. The role of the Australian Competition and Consumer Commission (ACCC) in relation to these rules is to advise the minister on the content of the rules and to monitor compliance with, and enforcement of, the rules.

The minister has written to the ACCC requesting advice on water charge rules by June 2009.¹ This paper sets out the ACCC’s final advice to the minister on the water infrastructure charge rules. This is accompanied by proposed rules—the draft water infrastructure charge rules.

In response to the minister’s request for advice, the ACCC released an issues paper in May 2008 on water charge rules for charges payable to irrigation infrastructure operators. This was followed by an issues paper on bulk water charge rules, released in July 2008. In September 2008 the ACCC released its position paper on water infrastructure charge rules, which brought together these two consultation processes. The ACCC then released its draft advice in April 2009.

The ACCC also held meetings with stakeholders throughout the process and held a public forum in Sydney on 30 April 2009 following the release of the draft advice.

The ACCC has received 72 written submissions in response to these papers and has had regard to these submissions in developing its advice and draft rules (see appendix 2 for a list of submissions). The issues papers, position paper, draft advice and draft rules, and submissions made to these papers can be viewed on the ACCC website (www.accc.gov.au).

Form of regulation

A key issue in developing the draft rules is the form of regulation to apply to the various types of operators across the MDB. This is discussed in chapter 3.

In developing the water infrastructure charge rules, the ACCC’s main objectives included developing rules that:

- contribute to achieving the Basin water charging objectives and principles (Schedule 2 of the Water Act)
- address the underlying market failure
- take into account the governance arrangements of infrastructure operators—whether an operator is member owned or non-member owned

¹ As required under s. 93(1) of the Water Act.

- take into account current and historical charging arrangements of infrastructure operators
- provide a net benefit.

The Basin water charging objectives and principles include to:

- promote the economically efficient and sustainable use of water resources and water infrastructure assets
- ensure that operators receive sufficient revenue to provide the required services
- facilitate efficient water markets
- give effect to the principles of user-pays
- achieve pricing transparency
- avoid perverse or unintended outcomes
- encourage full cost recovery
- ensure consistency in charging where entitlements are able to be traded.

The infrastructure associated with water supply and delivery exhibits natural monopoly characteristics, which means that competition is unlikely to develop between operators. In the absence of competition, prices, quality, service levels and innovation can diverge from competitive levels, which could result in less efficient market outcomes.

However, member ownership of natural monopolies is likely to provide sufficient incentives to ensure efficient investment and charging outcomes for member customers. Therefore, the risk of adverse outcomes in the absence of regulation is strongest for non-member owned operators.

Notwithstanding this, member owned operators might have incentives to unfairly discriminate against their non-member customers. Such discrimination could deter transformation and the trade of water entitlements out of the operator's district. This in turn could distort outcomes in the water market.

To address these concerns, the ACCC is recommending a three-tiered approach for the regulation of the various types of operators. The three tiers are to apply to operators depending on the type of market failure and the materiality of any resulting inefficiencies.

Tier 1 rules will address issues of discriminatory pricing and transparency. Publishing requirements to promote transparency will apply to all operators, with broader requirements applying for operators servicing more than 10 GL of entitlement. Non-discriminatory pricing rules will apply to all member owned operators, with approval or determination requirements applying to member owned operators that make a distribution to their members and that provide services in relation to more than 10 GL of entitlement.

Tier 2 rules will address concerns about asymmetric information and a lack of transparency in the processes used by operators to determine their charges. These will apply to the larger member owned operators and any medium-sized non-member owned operators not captured under tier 3.

Tier 3 rules will address the potential misuse of market power and resulting inefficiencies, and will apply to the larger non-member owned operators.

Each of these proposed tiers of regulation are discussed in more detail below.

Tier 1—transparent and non-discriminatory pricing

The primary purpose of the tier 1 rules is to improve the transparency of fees and charges and address the issue of discriminatory pricing practices.² The tier 1 rules will require that:

- operators publish, or otherwise make available, their schedule of regulated fees and charges
- there is no unwarranted price discrimination by operators against any non-member customer
- where member owned operators pay distributions, regulated fees and charges reflect a rate of return commensurate with the commercial risk involved.

Publishing requirements will apply to all operators. Broader publishing requirements will also apply to operators where the total volume of entitlement to which it and its customers are entitled in the MDB³ exceeds 10 GL. The non-discrimination rules will apply to all member owned operators, with additional safeguards applying where member owned operators servicing more than 10 GL of entitlement pay distributions to member customers.

Publishing requirements

Under the proposed publishing requirements, all operators will be required to:

- provide a current schedule of regulated fees and charges to their customers before the end of the three-month transitional period after the rules are registered
- provide a schedule of regulated fees and charges to their customers whenever there are changes to those fees and charges
- provide a schedule of regulated fees and charges to any new customers when they become a customer
- provide a copy of their current schedule of fees and charges to any person who requests it in writing within 20 business days of receiving the request.

Where the total volume of entitlement to which an operator and its customers are entitled exceeds 10 GL, that operator will also be required to publish its schedule of fees and charges on its website, in a newspaper (or newspapers) circulated in its area of operations or in the *Commonwealth of Australia Government Notices Gazette* (the Gazette). These operators will be required to do this each time changes are made to

² Schedule 2, clause 2(d) of the Water Act.

³ Or within the relevant state if the state has opted in to whole-of-state coverage under the Water Act.

their fees and charges. This provision is expected to apply to approximately 23 operators across the MDB (appendix 1).

The publishing requirements should contribute to achieving the Basin water charging objectives and principles by making market information readily available to market participants and by promoting pricing transparency for water storage and delivery services.⁴

The two levels of publishing requirements are intended to balance the compliance costs of broader publication of fees and charges with the increased benefit of making market information more widely available. The publishing requirements are discussed in more detail in chapter 4. Also, see Part 4 of the draft rules.

Non-discriminatory pricing requirements

The non-discrimination rules will apply to regulated water infrastructure charges⁵ levied on customers⁶ of member owned operators. These rules will prohibit differential charging towards non-member customers of member owned operators except where differentials reflect differences in actual costs necessarily incurred.

Discriminatory charging against non-member customers is likely to violate a number of the Basin water charging objectives and principles. In particular, discriminatory charging could deter transformation and/or trade, distort trade⁷ or result in operators moving away from user-pays charging.⁸

As the compliance costs of the proposed non-discriminatory pricing rules are likely to be small,⁹ the ACCC's view is that all member owned operators should be subject to these rules.

Member owned operators could also discriminate against their non-member customers through the payment of distributions to their members. Such discriminatory behaviour cannot be addressed through the non-discriminatory pricing rules and hence an additional safeguard is required. For these operators, the ACCC is proposing that it approve or determine charges by considering the rate of return used by the operator to set the level of charges.

⁴ Schedule 2, clause 2(d) of the Water Act.

⁵ These rules will apply to all regulated water charges except water management and planning charges and termination fees that are allowed over the water charge (termination fees) rules.

⁶ Customers include irrigators, stock and domestic users and private diverters.

⁷ One of the Basin water charging objectives is to facilitate the efficient functioning of water markets (Schedule 2, clause 2(c) of the Water Act). This requires irrigators to be able to transform and trade entitlements with minimal deterrents or distortions. Transformation is the process whereby an irrigator's irrigation right in relation to a group water entitlement held by an operator is converted into a separately held water entitlement.

⁸ Schedule 2, clause 2(d) of the Water Act.

⁹ For operators that already comply with this requirement, the costs are likely to be very low to nil.

However, in applying proportionate regulation, the ACCC considers that the size of an operator's business is another important factor. Hence, the ACCC is recommending that only member owned operators of a sufficient size—that is, the total volume of entitlement to which the operator and its customers are entitled within the MDB¹⁰ exceeds 10 GL—that pay a distribution or otherwise provide a financial benefit to their members be subject to these requirements.¹¹

The non-discriminatory charging requirements are discussed in more detail in chapter 4. Also, see Parts 3 and 7 of the draft rules.

Tier 2—network service plans

The tier 2 rules will apply to:

- member owned operators where the total volume of entitlement to which the operator and its customers are entitled within the MDB¹² exceeds 125 GL
- non-member owned operators where the total volume of entitlement to which the operator and its customers are entitled within the MDB¹³ exceeds 125 GL but is less than 250 GL.

Under current arrangements, Murrumbidgee Irrigation Limited, Murray Irrigation Limited, Coleambally Irrigation Cooperative Limited, Central Irrigation Trust and SunWater are expected to be subject to the tier 2 rules.

The proposed rules will require operators to:

- develop and consult on a network consultation paper (NCP) that details options for the operator's network over a five-year period
- develop and provide to customers a network service plan (NSP), based on the outcomes of the NCP consultation process, which details major capital works and associated expenditure and provides estimates of charges over a five-year period
- provide their NSP to the ACCC for review by an external engineering consultant and provide this review to customers
- publish a schedule of fees and charges before they come into effect
- develop and provide customers with a copy of an information statement¹⁴ that outlines and explains any changes from those anticipated in the NSP each time charges are to change.

¹⁰ Or within the relevant state if the state has opted in to whole-of-state coverage under the Water Act.

¹¹ This requirement is expected to capture member owned operators listed in appendix 1 that make distributions to member customers.

¹² Or within the relevant state if the state has opted in to whole-of-state coverage under the Water Act.

¹³ Or within the relevant state if the state has opted in to whole-of-state coverage under the Water Act.

¹⁴ The information statement was called an explanatory statement in the position paper, but terminology has been changed to avoid confusion with the explanatory statement required for regulation and legislation.

The development of an NCP and NSP should occur at least every five years but may occur more often at the discretion of the operator—for example, if there are unexpected changes in expenditure that require the NSP to be completely revised.

Operators will also be able to change charges (even where changes do not completely align with those proposed in the NSP) without needing to revise the NSP. In such circumstances, tier 2 operators will be required to publish the new schedule of fees and charges in line with the tier 1 requirements and to develop and provide to customers an information statement. The information statement must explain any changes and the reasons for those changes, including reasons for differences between the published fees and charges and those proposed in the NSP.

These rules should contribute to achieving the Basin water charging objectives and principles by:

- providing additional rigour around the price-setting processes of these operators
- ensuring that operators revisit their planning processes regularly enough to ensure they are earning sufficient revenue streams to deliver the required services
- promoting pricing transparency to facilitate efficient water use and trade
- ensuring that customers are able to provide input into an operator's planning and price-setting processes.

These benefits should outweigh any additional costs, especially as many of these operators already undertake similar processes and are large enough to absorb the additional costs.

More information on the tier 2 requirements is contained in chapter 5. Also, see Part 5 of the draft rules.

Tier 3—price approvals or determinations

The tier 3 requirements—price approvals or determinations—are to apply to non-member owned operators where the total volume of entitlement to which the operator and its customers are entitled within the MDB¹⁵ exceeds 250 GL. Under current arrangements, this threshold is expected to capture State Water, Goulburn-Murray Water and Lower Murray Water.

Tier 3 operators will be required to seek regulatory approval (or determination) for their charges over a defined regulatory period. For most operators, the regulatory period will be three years initially and four years for all subsequent periods. However, where an operator is also subject to price regulation in respect of its urban water supply activities, the ACCC may approve a period of a different length so as to align these two processes.

¹⁵ Or within the relevant state if the state has opted in to whole-of-state coverage under the Water Act.

Through the approval or determination process the regulator will assess the operator's proposed charges for the period and will approve or determine the charges for each year of the regulatory period. Charges in the second, third and fourth years of a regulatory period will also be adjusted before the commencement of each year to allow for updated demand (or consumption) forecasts to be used in determining charges.

The tier 3 rules include:

- the pricing principles to be used in approving or determining the level of charges
- the information that will be required from operators
- the processes that are to be followed by the regulator and regulated operators in having regulated water charges approved or determined
- any transitional arrangements.

The approval or determination of water charges is most likely to constrain market power, result in efficient water charges¹⁶ and consistent water charging practices across the MDB, and improve transparency. Therefore, it is likely to have the highest benefits compared with other regulatory options. However, it is a potentially costly option and should only apply where an operator's governance arrangements do not limit the potential for misuse of market power and where an operator is large enough that the potential impact warrants further regulation. Hence, the ACCC believes that only non-member operators that are sufficiently large should be subject to the tier 3 rules.

The draft rules establish transitional arrangements which provide for the New South Wales Independent Pricing and Regulatory Tribunal to be responsible for undertaking the next determination for State Water. In addition, current determinations made by the Essential Services Commission in Victoria will remain in force until their expiry. Upon the expiry of these price paths, the proposed rules give the ACCC responsibility for undertaking approvals or determinations across the MDB on the basis that this would be most effective in contributing to achieving the Basin water charging objectives and principles.

In particular, regulation by the ACCC rather than state-based regulators is more likely to result in consistent water charging across the Basin, which in turn will facilitate more efficient water markets and the efficient use of water resources and water infrastructure assets. Further, this approach is preferred given the ACCC's monitoring and enforcement role under the Water Act. The ACCC considers that, on balance, this approach will offer the highest net benefit compared with an approach where multiple regulators are responsible for undertaking approvals or determinations. A more prescriptive, complex and costly framework would need to operate in order to ensure consistency of approach with multiple regulators undertaking approvals or determinations across the Basin. The ACCC also notes that the mechanism to achieve accreditation does not currently exist—it would likely require the relevant state to enact legislation providing for the state agency to undertake approvals or determinations under the rules, and to confer any other necessary or incidental powers onto the state

¹⁶ Efficient water charges should facilitate efficient water use, trade and investment in water infrastructure assets, which are Basin water charging objectives under the Water Act.

agency. For these reasons the rules do not provide for the accreditation of state agencies to undertake approvals or determinations. These issues are discussed in greater detail in section 3.2.7.

More information on approvals and determinations is contained in chapter 6. Also, see Part 6 of the draft rules.

Amendments to the draft advice

Following further consultation and consideration, the ACCC has made changes to some of its positions in the draft advice. These amendments are discussed below.

In relation to the timing of the tier 1 publishing requirements, the ACCC has changed the period between the operator providing its schedule of fees and charges to customers and the operator levying those fees and charges to two weeks (from one month). This change was made in response to industry concerns that, in practice, operators set charges as close to the billing time as possible in order to best adjust the charges to likely water availability (water allocations).

In relation to the tier 1 publishing requirements of operators servicing over 10 GL of entitlement, these operators may now publish their schedule of fees and charges on a publicly accessible part of their internet site instead of in the Gazette or in a newspaper (or newspapers) circulating in their area of operations. The Gazette and newspaper options have been retained, however, for operators that might not have an internet site. This change was made in response to comments of interested parties that the internet would be a less costly and more efficient means of communicating with their customers and other market participants.

In relation to the tier 2 rules, the ACCC has provided a longer transitional period to provide operators with more time to fulfil their obligations and to better align the commencement of the rules with the start of the irrigation season. Tier 2 operators now have until 1 July 2011 to complete the tier 2 requirements.

Also in relation to the tier 2 requirements, the ACCC will commission an engineer to review tier 2 operators' NSPs (rather than requiring these operators to undertake this task). Tier 2 operators must give the NSP to the ACCC when they provide it to their customers or they may provide it to the ACCC before this time in order to incorporate any recommendations from the engineer into the final NSP. This change was made in response to concerns raised by interested parties that commissioning an independent engineer would be an expensive exercise that would add little value since these operators usually have sufficient in-house expertise to verify their NSP.

Changes have been made to the tier 3 rules so that the approval or determination undertaken prior to the commencement of a regulatory period will be in relation to charges in each year of the regulatory period (rather than just in the first year of a regulatory period). Charges will then be updated in the second, third and fourth year of the regulatory period to adjust for changes in demand or consumption forecasts. In approving or determining charges in these subsequent years, the ACCC may also consider the impact of any proposed charges on price stability across the regulatory

period. These changes have been made to give more certainty to operators and customers around price and revenue stability.

Also in relation to the tier 3 rules, the ACCC has recommended a rule to allow it to align the length of the regulatory period with the length of a regulatory period that has been determined by another regulatory body where an operator is subject to regulation of its urban prices by that other regulatory body. This rule should address the concerns of Lower Murray Water that it would be subject to determinations that did not align in respect of its urban water charges and its rural water charges.

The tier 3 rules have also been amended to include the ACCC's policy commitment to retain the value of an operator's regulatory asset base (RAB) where it has previously been set by a state agency. This will mean that the operator (and the ACCC) is now bound to the value of the RAB determined by the state agency before the commencement of the tier 3 approval or determination process. The draft rules also specify how the RAB must be rolled forward each regulatory period. This will ensure that there is no systematic revaluing of the RAB which would result in price shocks to customers. This new rule and schedule do not constitute a change in policy but instead provide greater certainty about how the ACCC would enact its previously stated policy commitment.

Other amendments have been made to the rules to provide greater clarity and to ensure that the rules reflect the policy intent as outlined in this advice.

1 Introduction

The Murray–Darling Basin (MDB) extends across four states and one territory and is Australia’s most important agricultural region.

The *Water Act 2007* (Cwlth) (the Water Act), which came into effect on 3 March 2008, creates new institutional and governance arrangements to address the sustainability and management of water resources in the Basin. The Water Act builds on earlier reform initiatives, including the National Water Initiative (NWI) and the Murray–Darling Basin Agreement (MDB Agreement). The Water Act creates new functions for the Australian Competition and Consumer Commission (ACCC) (see chart 1.1).

The Water Act gives the Minister for Climate Change and Water (the minister) the role of making water charge rules. The ACCC’s role is to advise the minister on those rules and to monitor and enforce compliance with the rules.¹⁷

The main objectives of the NWI and the Water Act are to promote the efficient use of, and investment in, water infrastructure and to facilitate the efficient operation of water markets.¹⁸ Water charge rules that encourage full cost recovery¹⁹ for water services will contribute to achieving an economically efficient and sustainable use of water resources and water infrastructure assets.²⁰ Water charge rules applied consistently and transparently across the Basin²¹ will facilitate the efficient functioning of water markets²² by removing distortions to trade and by sending signals about efficient investment in water infrastructure assets.

This paper is the ACCC’s final advice to the minister on the water charge rules for water infrastructure fees and charges levied by water infrastructure operators, including bulk water operators and irrigation infrastructure operators.²³

The ACCC’s advice on water charge rules for recovery of water planning and management costs is being developed through a separate consultation process and is not the subject of this paper.

¹⁷ Sections 93(2), 94, 100A and 100D of the Water Act.

¹⁸ Clauses 58 and 64 of the NWI, and Schedules 2 and 3 of the Water Act.

¹⁹ Schedule 2, clause 3(3) of the Water Act.

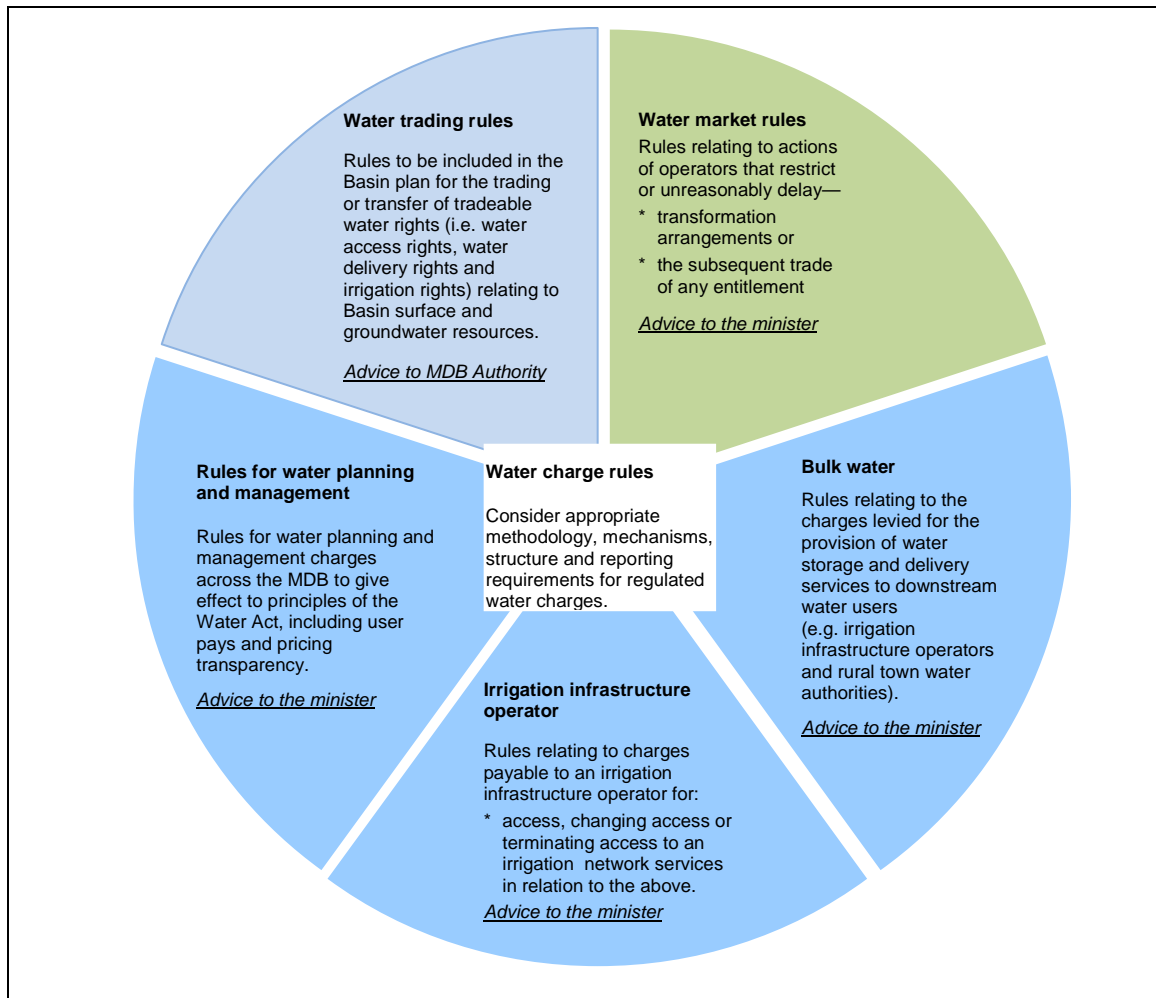
²⁰ Schedule 2, clause 2 of the Water Act.

²¹ Schedule 2, clause 3(7) of the Water Act.

²² Schedule 2, clause 2(c) of the Water Act.

²³ Water charge (termination fees) rules have been made and are available on the ACCC website. Water charge rules for water planning and managements are being developed under a separate process.

Chart 1.1: Roles of the ACCC under the Water Act



1.1 Consultation process

In developing its final advice on water infrastructure charge rules, the ACCC undertook an extensive consultation process. The ACCC has released the following papers for consultation:

- an issues paper on water charge rules for charges payable to irrigation infrastructure operators
- an issues paper on bulk water charge rules
- a position paper on water charge rules for charges payable to irrigation operators and bulk water operators
- draft advice and draft rules.

The ACCC received a total of 72 submissions in response to these papers (a list of submissions is contained in appendix 2). All written submissions are publicly available on the ACCC's website.

At each stage of the consultation process, the ACCC invited comment from the Basin state water ministers and agencies, operators, interested stakeholders and the public. The ACCC also published notices in national and regional newspapers and on the internet notifying stakeholders of the public forum and inviting submissions in response to the issues papers, position paper and draft advice.

The ACCC held numerous meetings with key stakeholders throughout the public consultation process. The consultation process also provided stakeholders with the opportunity to discuss issues directly with commissioners and the ACCC. The final advice takes into account all of the submissions and comments made in meetings and the public forum.

1.1.1 Issues papers

The issues paper on water charge rules for charges payable to irrigation infrastructure operators was released for public consultation on 30 May 2008. The issues paper addressed all regulated water charges payable to irrigation infrastructure operators. Submissions in response to the issues paper were due on 15 July 2008. The ACCC received 31 written submissions, many of which addressed termination fees.

An issues paper on bulk water charge rules was released on 7 July 2008. The issues paper addressed the issues relating to bulk water charge rules and charges payable to bulk water operators. Submissions to the issues paper were due on 18 August 2008. A total of 14 written submissions were received in response to this issues paper.

1.1.2 Position paper

On 30 September 2008, the ACCC released the position paper on water charge rules for infrastructure operators for public consultation.

As a result of the proposed changes to the Water Act under the Intergovernmental Agreement on Murray–Darling Basin Reform,²⁴ the ACCC began developing water charge rules applicable to irrigation infrastructure and bulk water operators (infrastructure operators) as part of a joint process. Accordingly, the position paper brought together the previously separate strands of rules development and set out the ACCC’s preliminary positions for charges payable to irrigation infrastructure operators and bulk water operators.²⁵ Submissions in response to the position paper were due on 24 November 2008, and the ACCC received 16 written submissions.

1.1.3 Draft water infrastructure charge rules and draft advice to the minister

The ACCC’s draft advice on water infrastructure charge rules (the draft advice), including draft water infrastructure charge rules (the draft rules) and an accompanying explanatory statement, was released for public consultation on 6 April 2009.

²⁴ See http://www.coag.gov.au/coag_meeting_outcomes/2008-07-03/docs/Murray_Darling_IGA.pdf.

²⁵ Charge rules for termination fees were developed through a separate process.

Submissions in response to the draft advice, including the draft rules and explanatory statement, were due on Friday 8 May 2009, and the ACCC received a total of 11 written submissions.

1.1.4 Public forum

As part of its consultation process, the ACCC held a public forum in Sydney on Thursday 30 April 2009 following the release of the draft advice and draft rules. Notes and presentations made at the public forum are available on the ACCC website.

1.2 Structure of paper

This paper is structured as follows:

Chapter 2 outlines the legal framework establishing the scope and purpose of the water charge rules with respect to water infrastructure fees and charges.

Chapter 3 outlines the market failure that the rules are intended to address and the general form of regulation for the water charge rules.

Chapter 4 outlines the tier 1 water charge rules, which will require all operators to publish regulated water charges and prevent discriminatory pricing.

Chapter 5 outlines the tier 2 rules, which will require larger member owned operators and medium-sized non-member owned operators to follow certain procedures when determining their regulated water charges.

Chapter 6 outlines tier 3 rules, which will require larger non-member owned operators to be subject to approvals or determinations of their regulated water charges.

Chapter 7 outlines monitoring and enforcement arrangements under the water infrastructure charge rules.

2 Water charge rules

This section considers the legal framework that applies to the water charge rules, including amendments to the *Water Act 2007* (Cwlth) (the Water Act) made by the *Water Amendment Act 2008* (Cwlth).²⁶

The Water Act gives the Minister for Climate Change and Water (the minister) the role of making water charge rules. The role of the Australian Competition and Consumer Commission (ACCC) is to advise the minister on those rules and to monitor and enforce compliance with the rules.²⁷

Water charge rules are rules that must be applied when determining regulated water charges, including rules relating to water infrastructure fees and charges levied by bulk water and irrigation infrastructure operators.

As a result of the amendments to the Water Act, the water charge rules apply to water charges as they relate to:

- Basin water resources
- water service infrastructure that carries Basin water resources
- water service infrastructure that carries water that has been taken from a Basin water resource
- water access rights, irrigation rights or water delivery rights in relation to Basin water resources.²⁸

Further, Basin jurisdictions may elect to make water charges outside the Basin subject to the water charge rules.²⁹

The water charge rules do not apply to charges in respect of urban water supply activities beyond the point at which the water has been removed from a Basin water resource.³⁰

²⁶ The Water Amendment Act came into force on 15 December 2008.

²⁷ Sections 93(2), 94, 100A and 100D of the Water Act.

²⁸ Section 91(2) of the Water Act.

²⁹ This was provided for at a Council of Australian Governments meeting (see COAG, *Agreement on Murray-Darling Basin Reform*, 3 July 2008, paragraphs 2.4.4 and 6.17 to 6.19) and then enacted in legislation (see Part 4A of the Water Act). As yet, no Basin jurisdiction has endeavoured to pass legislation to allow implementation of the rules outside the Basin.

³⁰ Section 91(3) of the Water Act.

2.1 What are the objectives of the water charge rules?

The Water Act states that the water charge rules must contribute to achieving the Basin water charging objectives and principles.³¹ These objectives, which are drawn from the National Water Initiative (NWI),³² include:

- promoting economically efficient and sustainable use of water resources and water infrastructure assets
- facilitating efficient functioning of water markets
- implementing user pays principles
- achieving transparent pricing and cost recovery
- avoiding perverse or unintended pricing outcomes.

The Water Act also states that, in providing advice to the minister on proposed water charge rules on charges payable to infrastructure operators,³³ the ACCC must have regard to the:

- governance arrangements of those operators
- current charging arrangements of those operators
- history of charging arrangements of those operators (see appendix 4).

2.2 What is the scope of the water charge rules?

The Water Act and the subsequent amendments made by the Water Amendment Act provide that the water charge rules may deal with the following matters:

- rules that must be applied in determining the amount of regulated charges³⁴
- terms and conditions that may, or must not, be imposed in relation to regulated charges³⁵
- prohibition of regulated charges of a particular kind in specified circumstances³⁶
- the imposition of a requirement on the person determining the amount of regulated water charges to publish the details of the charges and the process for determining the amount of the charges³⁷

³¹ Schedule 2 of the Water Act.

³² Section 92(1)(c) and Schedule 2 of the Water Act. The Basin water charging objectives and principles are set out in full in appendix 3.

³³ As defined under s. 7 of the Water Act.

³⁴ Section 92(3)(a) of the Water Act.

³⁵ Section 92(3)(b) of the Water Act.

³⁶ Section 92(3)(i) of the Water Act.

³⁷ Sections 92(3)(j)(i) and (ii) of the Water Act.

- transitional arrangements for the introduction of, or changes to, water charge rules³⁸
- rules that deal with the determination, or approval, by the ACCC of regulated water charges, including:³⁹
 - the process to be followed in applying for, and making or giving, determinations or approvals
 - the effect, and duration, of a determination or approval
 - the information that an applicant for a determination or approval must give the ACCC about the application
 - the timing of the steps in the process in which the application and the determination are made or the approval is given
- the accreditation by the ACCC of arrangements under which regulated water charges are determined or approved by agencies of the states.⁴⁰

2.3 What fees and charges do the rules cover?

The draft rules cover the following types of regulated water charges:

- bulk water charges⁴¹
- fees or charges payable to an irrigation infrastructure operator for access to, or changing access to, the operator's irrigation network, or services provided in relation to that access⁴²
- a fee or charge that relates to:
 - access to water service infrastructure
 - services provided in relation to access to water service infrastructure
 - services provided through the operation of water service infrastructure or
 - the taking of water from a water resource
 and of the kind prescribed under regulations.⁴³

A bulk water charge is defined under s. 4 of the Water Act as a charge payable for the storage of water for, and the delivery of water to, any of the following:

- infrastructure operators
- other operators of reticulated water systems

³⁸ Section 92(3)(k) of the Water Act.

³⁹ Sections 92(3)(c), 92(3)(d), 92(4) and 92(5) of the Water Act.

⁴⁰ Section 92(3)(e) of the Water Act.

⁴¹ Section 91(1)(b) of the Water Act.

⁴² Sections 91(1)(a)(i) and (ii) of the Water Act.

⁴³ Section 91(1)(d) of the Water Act.

- other persons prescribed by the regulations for the purposes of this paragraph.

An infrastructure operator is defined as any person or entity that operates water service infrastructure for the storage, delivery or drainage of water. Where the primary purpose of the water infrastructure is delivering irrigation water to another person (for example, an irrigator) the operator is an irrigation infrastructure operator.⁴⁴

The Department of the Environment, Water, Heritage and the Arts (DEWHA) is in the process of developing regulations for the purposes of the following provisions of the Water Act:

- paragraph (c) of the definition of ‘bulk water charge’ in s. 4(1)
- paragraph 91(1)(d) relating to the definition of ‘regulated water charge’.⁴⁵

The purpose of the proposed regulations is to:

- expand the definition of bulk water charges
- capture a greater range of charges associated with non-contestable services provided by infrastructure operators under the water charge rules. These include charges imposed for services associated with access to water service infrastructure that is not an irrigation network and charges for terminating access to water supply infrastructure that is not an irrigation network.

These regulations, if made, will expand on the types of charges that fall within the definition of regulated water charge and will therefore affect the scope of the water charge rules under the Water Act.

The draft rules have been drafted so as to provide for the inclusion of these additional regulated water charges if the regulations are made.

2.3.1 Views of interested parties

The issue of the scope of the water charge rules as they apply to different water infrastructure operators and users was raised in a number of the submissions to the position paper and to the draft advice. It was also one of the key issues discussed at the public forum.

Comments were in relation to which users and which operators will be covered by the rules.

Which users are covered

The following comments were made in response to the position paper.

The National Farmers’ Federation (NFF) stated:

⁴⁴ Section 7 of the Water Act.

⁴⁵ DEWHA was accepting submissions on the draft regulations until 27 March 2009.

NFF supports that other users inside the Basin should form part of the definition under bulk water charges. The key here is consistency and simplification not complication.⁴⁶

Central Irrigation Trust (CIT) stated it would ‘like to see the water charge rules apply only to irrigation customers’.⁴⁷

The NSW Irrigators’ Council (NSWIC) stated:

NSWIC reaffirms its submission that consumption users are not – and must not be considered – the only users in terms of bulk water services. Recreational, other consumptive and particularly environmental users must be taken into account.⁴⁸

State Water stated that it ‘supports the intention of ACCC to extend the definition of a water user via regulation’.⁴⁹

The following comments were made in response to the draft advice.

Gwydir Valley Irrigators Association Inc. (GVIA) noted that the definition of a bulk water charge does not include ‘customers of State Water who are direct diverter[s]’.⁵⁰ It further noted:

GVIA is aware of draft regulations that would include direct diverters in the definition, and seeks assurances from the ACCC and the Minister that the proposed change to the definition by way of regulation will be enacted.⁵¹

State Water was also supportive of an extended definition of bulk water charges to include all water users:

State Water has previously supported the efforts of the Department of Environment, Water, Heritage and the Arts (DEWHA) to establish a regulation under the Water Act 2007 to expand the definition of water users so that the proposed water charge rules cover all of State Water’s customers (and indeed all users extracting water from NSW Rivers) State Water regards the proposed regulation as positive.⁵²

Which operators are covered

The following comments were made in response to the position paper.

The New South Wales Independent Pricing and Regulatory Tribunal (IPART) commented on the exclusion of River Murray Water (RMW) under the water charge rules:

⁴⁶ NFF, submission to the ACCC water charge rules position paper, December 2008, p. 5.

⁴⁷ CIT, submission to the ACCC water charge rules position paper, November 2008, p. 2.

⁴⁸ NSWIC, submission to the ACCC water charge rules position paper, December 2008, p. 5.

⁴⁹ State Water, submission to the ACCC water charge rules position paper, November 2008, p. 4.

⁵⁰ GVIA, submission to the ACCC water infrastructure charge rules draft advice, May 2009, p. 3.

⁵¹ *ibid.*

⁵² State Water, submission to the ACCC water infrastructure charge rules draft advice, May 2009, p. 3.

IPART notes that the trading arm of the current Murray Darling Basin Authority – River Murray Water – appears to sit entirely outside the ACCC’s proposed regulatory regime. IPART considers that the costs of this operator should be separately identified and reviewed and that its bulk water charges should be set through a price determination (Tier 3) process.⁵³

This was also raised by the NFF in relation to the ability of the charge rules to capture activities undertaken by the Murray–Darling Basin Authority (MDB Authority). The NFF noted:

... that there is no requirement in the position paper that reflect the requirement to deal with Murray-Darling Basin Authority costs. Therefore, NFF seeks clarification on the status of these costs within each of the States, i.e. does the ACCC, like in the Water Planning and Management Issues Paper, have no authority to ensure irrigators in each of the States pay for the full costs to recover MDB Authority costs incurred by their respective State Governments?⁵⁴

Similarly, State Water noted:

... the MDBA [Murray–Darling Basin Authority] is excluded [from the water charge rules] on the basis that it does not have a separate water charge ...

Until the ACCC water charge rules are extended to all activities within the water market, it is likely that they will distort trade and disadvantage those jurisdictions which are already compliant with the NWI charging principles.⁵⁵

The following comments were made in response to the draft advice.

State Water noted:

Under the proposed arrangements, the Water Charge rules are only applicable to those operators that currently charge them ... This situation is inconsistent with the efficient functioning of water markets and the user pays principle, both of which are key objectives of the charge rules ...

State Water urges the ACCC to pursue changes to the Commonwealth Water Act 2007 to mandate all operators be subject to the water charge rules.⁵⁶

GVIA also noted its concerns:

GVIA remains very concerned about the limited authority the Water Act gives for the actual imposition of regulated water charges ...⁵⁷

⁵³ IPART, submission to the ACCC water charge rules position paper, November 2008, p. 5.

⁵⁴ NFF, submission to the ACCC water charge rules position paper, December 2008, p. 5.

⁵⁵ State Water, op. cit., p. 1.

⁵⁶ State Water, submission to the ACCC water infrastructure charge rules draft advice, May 2009, p. 1.

⁵⁷ GVIA, submission to the ACCC water infrastructure charge rules draft advice, May 2009, p. 2.

NSWIC similarly stated:

The Rules suffer from exactly the same problem identified by NSWIC in previous submissions – they can apply only to regulated water charges. Where such a charge does not exist – as is the case in several parts of the Basin – these Rules will not apply.⁵⁸

Similarly, Western Murray Irrigation (WMI) noted:

The Water Infrastructure Charge rules only apply to “regulated water charges”. If the charge does not exist the regulation does not apply which adds to the continuing lack of competitive neutrality and equity for customers in the Basin.⁵⁹

Murrumbidgee Irrigation Limited (MI) noted:

Unless specifically exempt, an infrastructure operator that is not subject to the water charge rules (and ACCC assessment, monitoring and review) should not be allowed to levy charges.⁶⁰

The coverage of the rules was also a key theme at the public forum. A number of forum participants—including State Water and Murray Irrigation Limited—noted their concern that the rules would not apply to operators that do not currently levy a charge.

2.3.2 ACCC assessment

A number of stakeholders have raised concerns in relation to which users will be captured by the water charge rules. As noted above, DEWHA is in the process of developing regulations under the Water Act to extend the types of users captured by the rules.

The Water Act imposes limits on what the water charge rules can deal with by restricting the application of the rules to regulated water charges (effectively requiring a charge to exist for the rules to apply).⁶¹ Additionally, the Water Act does not give the minister or the ACCC the power to require a charge to be levied. This limitation does have practical implications—RMW and the MDB Authority do not levy charges and hence are not currently captured by the rules.

As can be seen from the above section, a number of stakeholders have raised concerns about the water charge rules not applying to the MDB Authority in particular. The ACCC notes that since the MDB Authority, through RMW, provides water storage and delivery services, its activities would be captured if the Water Act referred to the regulation of ‘services’ rather than ‘charges’. However, this would require amendment to the Water Act.

Alternatively, the water charge rules would apply to the MDB Authority and RMW if these authorities introduced charges for their water storage and delivery services.

⁵⁸ NSWIC, submission to the ACCC water infrastructure charge rules draft advice, May 2009, p. 5.

⁵⁹ WMI, submission to the ACCC water infrastructure charge rules draft advice, May 2009, p. 4.

⁶⁰ MI, submission to the ACCC water infrastructure charge rules draft advice, June 2009, p. 4.

⁶¹ Section 92 of the Water Act.

3 Form of regulation

As discussed in the draft advice, a key issue for the water charge rules is the form of regulation that should apply to the various types of operators across the Basin.

In the draft advice it was identified that water storage and delivery infrastructure exhibit natural monopoly characteristics—meaning there is a lack of scope for conventional competitive forces. In this way, all infrastructure operators have a certain degree of market power. Hence, there is a *prima facie* case for regulating these operators.

However, it was also identified that the ownership and governance arrangements of some operators might lessen the potential risk that these operators will misuse their market power. In particular, member owned operators are accountable to their members and are therefore likely to pursue efficiency in the level of prices, services and investment for their member customers.

The concern with member owned operators was, instead, that these operators might discriminate against their non-member customers. Such discrimination could be through either:

- higher charges for non-member customers relative to member customers
- the payment of distributions to member customers, where such distributions do not reflect the commercial risks involved.

Member owned operators have the incentives to engage in such behaviour in order to reduce net charges levied on member customers. This could discourage member customers from transforming⁶² their entitlement, which could in turn deter or distort water trade.

To address these concerns, the ACCC proposed a three-tiered regulatory framework to best achieve the Basin water charging objectives and principles. This approach was assessed as delivering the greatest net benefit compared with other regulatory models.

The proposed tiers included:

- tier 1—rules to ensure there is no discriminatory charging against non-member customers by member owned operators and that fees and charges of all operators are made publicly available
- tier 2—rules to require large member owned operators and medium-size non-member owned operators to undertake certain procedural and publishing requirements in determining their charges
- tier 3—rules to require the ACCC to approve or determine regulated water charges for large non-member owned operators.

⁶² Transformation is the process whereby an irrigator's irrigation right, in relation to a group water entitlement held by an operator, is converted into a separately held water entitlement.

The remainder of this chapter is divided into two sections: a summary of submissions received in response to the position paper and draft advice, and a discussion of the ACCC's assessment.

3.1 Views of interested parties

Fifteen submissions were received in response to the position paper. Ten of these addressed the issue of the form of regulation. Of these, nine were generally supportive of the approach proposed by the ACCC.

Eleven submissions were received in response to the draft advice. Of these, only two addressed the issue of the form of regulation generally and both were supportive of the ACCC's proposed approach.

This section summarises the views received in submissions to the position paper and the draft advice on the form of regulation. These are arranged by topic.

3.1.1 General support for a three-tiered approach

The following comments were received in response to the position paper.

On the ACCC's proposed approach, the National Farmers' Federation (NFF) noted:

... the approach taken by the ACCC in this issues paper is practical, cost effective and not unduly prescriptive, particularly for small operators – thus allowing this group in particular to put in place some changes to ensure greater pricing transparency. NFF welcomes the proposal for a three-tiered approach ...⁶³

The New South Wales Independent Pricing and Regulatory Tribunal (IPART) noted the following in relation to the ACCC's proposed form of regulation:

IPART supports many elements of the three-tiered approach to the regulation of bulk water and irrigation infrastructure operators proposed in the Position Paper. IPART recognises the importance of targeted and proportionate regulation.⁶⁴

Murrumbidgee Horticulture Council Inc. (MHC) noted:

MHC supports the development of tiered rules as a means of regulating operators of different scale and type and notes the recommended steps to reduce the regulatory burden on operators (particularly phase in periods and development of guidelines).⁶⁵

Macquarie River Food and Fibre (MRFF) was also supportive of the proposed regulatory approach:

MRFF commends ACCC on its consideration of the issues of size, need and capacity of operators in determining the appropriate level of regulation.⁶⁶

⁶³ NFF, submission to the ACCC water charge rules position paper, December 2008, p. 4.

⁶⁴ IPART, covering letter to its submission to the ACCC water charge rules position paper, November 2008, p. 1.

⁶⁵ MHC, submission to the ACCC water charge rules position paper, November 2008, p. 1.

The NSW Irrigators' Council (NSWIC) stated the following:

NSWIC concurs with the three tiered approach. It recognises that infrastructure operators cannot be excused, but at the same time notes the significantly varying nature, size and scope of operators across the Basin.⁶⁷

State Water generally supported the proposed regulatory approach:

State Water is generally supportive of the three tier approach to the rules, to avoid undue regulatory burden on smaller, not for profit irrigation infrastructure operators.⁶⁸

Western Murray Irrigation (WMI) thought that the tiered approach would satisfy its recommended objectives:

WMI had three core objectives for the Water Charge Rules as noted in its original submission:

- Inappropriate regulation should not be established ...
- The Rules should not interfere with an infrastructure operator's right to conduct the business of irrigation management ...
- The Rules should be flexible to allow external factors to be considered.

WMI believe the ACCC in its position paper have dealt with each of these objectives in a positive way through its introduction of a tiered approach and respecting processes that are already in place.⁶⁹

The Queensland Government was generally supportive of the ACCC's proposed regulatory approach:

In general, Queensland concurs that the preliminary positions set out in the Water Charge Rules Position Paper will contribute towards meeting the objectives of the National Water Initiative and the Water Act 2007 as set out in Schedule 2. In particular, Queensland welcomes the three tier approach to economic regulation and commends the ACCC for advocating an approach that takes into account size and governance arrangements of infrastructure operators.⁷⁰

The Victorian Government noted:

The ACCC recognised the need for the chosen form of regulation to offer the highest net benefit compared with all other available options. The Victorian Government supports this approach, including the adequate and objective assessment of the costs and likely benefits of the ACCC's proposals, as well as comparisons to the existing State-based regulatory regimes.⁷¹

⁶⁶ MRFF, submission to the ACCC water charge rules position paper, November 2008, p. 2.

⁶⁷ NSWIC, submission to the ACCC water charge rules position paper, November 2008, p. 3.

⁶⁸ State Water, submission to the ACCC water charge rules position paper, November 2008, p. 2.

⁶⁹ WMI, submission to the ACCC water charge rules position paper, November 2008, p. 2.

⁷⁰ Queensland Government, submission to the ACCC water charge rules position paper, December 2008, p. 1.

⁷¹ Victorian Government, submission to the ACCC water charge rules position paper, January 2009, p. 1.

In response to the draft advice, the Government of South Australia noted:

The Government of South Australia supports the ACCC's position that a three-tiered approach be adopted for the water charge rules.⁷²

Also in response to the draft advice, the Victorian Government noted:

The [Victorian] Government supports the development of efficient and integrated Murray-Darling Basin (MDB) water markets and recognises the important role of the water charge rules in contributing to this objective.

The [Victorian] Government also support's the ACCC's proposed regulatory framework to govern rural water charges.⁷³

3.1.2 Market failure for member owned operators

The following comments were received in response to the position paper.

NSWIC did not believe that the ACCC had adequately identified the market failures that the regulation is intended to address:

The Paper identifies that the ACCC prefers a three tiered approach 'to apply to operators depending on the type of market failure that the rules are addressing...'. At no stage, however, has the ACCC investigated or identified these theoretical market failures, despite the encouragement of NSWIC and others to do so. We have no doubt that the vast majority of identifiable market failure lies within government owned infrastructure operators and departmental administrative process that significantly delays trade.⁷⁴

Murrumbidgee Irrigation Limited (MI) argued that the 'ACCC has not provided any evidence for member owned operators market failure'.⁷⁵ In addition, MI noted that it did not see a role for regulation given the ownership arrangements of member owned operators:

It would appear from this position paper that the ACCC envisages a role in regulating ... price setting, infrastructure planning, customer consultation, service standards, dividend policy and financing. MI directors and management have the ultimate responsibility to the customer/shareholders to govern the business to acceptable standards including the functions described above. We see no role for the ACCC in regulating how these functions are undertaken in private sector companies such as ours, where there are effective, self-regulating checks and balances.⁷⁶

⁷² Government of South Australia, submission to the ACCC water infrastructure charge rules draft advice, May 2009, p. 1.

⁷³ Victorian Government, submission to the ACCC water infrastructure charge rules draft advice, May 2009, p. 1.

⁷⁴ NSWIC, op. cit., pp. 2–3.

⁷⁵ MI, submission to the ACCC water charge rules position paper, December 2008, p. 8.

⁷⁶ *ibid.*, p. 4.

MI added:

Member owned operators do not require the level of regulation deemed necessary by the ACCC for a government owned business model in the water industry.⁷⁷

MI also stated:

... the ACCC needs to identify other private industries where this level of regulation is mandated and the clear benefits that such regulations have provided for consumers and the economy.⁷⁸

Instead, for member owned operators, MI stated, it:

... favours consistency, a low cost irrigator model, openness and transparency in its dealings with all MI shareholders and irrigators, reinforced and driven by the irrigator owned business model.⁷⁹

MI noted:

Ultimately, if standards drop, our customers will firstly exercise their democratic right to change company directors and direction and in the absence of success they can remove their investment from the district.⁸⁰

In response to the draft advice, NSWIC stated:

It appears that the ACCC have adopted a position that the absence of competition is market failure.

NSWIC disputes this simplistic definition ... In order to justify that additional cost burden, irrigators demand that the ACCC identify market failure and the benefit that the rules will bring.

NSWIC submits that 'market failure' is not simply the absence of competition, or the presence of monopoly – it is the lack of mirrored competitive behaviour.⁸¹

3.1.3 Market power as evidenced through discriminatory behaviour

In relation to operator dividends, Mark Cameron, in his submission to the position paper, noted:

Dividends are a tool that could cause undue discrimination and are more likely to lead to monopoly rents. I propose that if an operator wishes to pay dividends then it should become a tier 3 operator.⁸²

⁷⁷ *ibid.*, p. 5.

⁷⁸ *ibid.*, p. 8.

⁷⁹ *ibid.*, p. 10.

⁸⁰ *ibid.*, p. 8.

⁸¹ NSWIC, submission to the ACCC water infrastructure charge rules draft advice, May 2009, p. 5.

⁸² M Cameron, submission to the ACCC water charge rules position paper, November 2008, p. 1.

3.1.4 Movement between the tiers

In response to the position paper, IPART suggested:

Consideration [should] be given to providing scope for Tier 1 and Tier 2, member owned, operators to be moved up or down Tiers. This would provide these operators with a strong incentive to comply with the water charge rules ...⁸³

In the same submission, IPART also noted that the ownership status of operators could change over time and the rules should be responsive to this:

... the ACCC's proposed water charge rules are based on ownership status. However, IPART considers that these rules should provide for the possibility of ownership status changing over time – for example, if a member owned operator becomes non-member owned or if, as the result of water trading, a change occurs in the proportion of customers that are non-members.⁸⁴

3.1.5 Application of the rules

In response to the position paper, IPART recommended that all non-member owned operators should be subject to the tier 3 rules irrespective of their size:

IPART recommends that, along with all other non-member operators, SunWater and SA Water should be subject to Tier 3 rules (and independent price determination). IPART notes, however, that the review and determination of these operators' prices could be proportionate to the size of their operations within the Basin.

... IPART notes that the trading arm of the current Murray Darling Basin Authority – River Murray Water – appears to sit entirely outside the ACCC's proposed regulatory regime. IPART considers that the costs of this operator should be separately identified and reviewed and that its bulk water charges should be set through a price determination (Tier 3) process.⁸⁵

Also in response to the position paper, the Queensland Government stated:

... it is appropriate that SunWater is a Tier 2 Operator for the purposes of economic regulation in the Murray-Darling Basin. Greater transparency and asymmetry of information relating to SunWater's prices are welcome as this will promote a better understanding of water pricing for water users. This will lead to water users making more informed decisions relating to efficient water use, investment and trading.⁸⁶

In response to the draft advice, Lower Murray Water (LMW) noted:

LMW has been categorised in Tier 3 based on the quantum of water entitlement managed by this Corporation ... The vast quantum of this entitlement, being 327.8 GL is held by private diverters ... We contend that the private diverter component of entitlement should be discounted from the criteria when determining which tier LMW should be placed in.

⁸³ IPART, covering letter to its submission to the ACCC water charge rules position paper, November 2008, p. 2.

⁸⁴ *ibid.*, p. 4.

⁸⁵ IPART, submission to the ACCC water charge rules position paper, November 2008, p. 5.

⁸⁶ Queensland Government, *loc. cit.*

LMW only manages the licensing component for private diverters and applies pass through costs to this group that have separately been determined by Goulburn Murray Water as the State's nominated headwork's manager.

Post the 2007/08 financial year LMW merged with the First Mildura Irrigation Trust (FMIT) which now places our direct irrigation customer entitlement at 174.3 GL ... Clearly this falls within the Tier 2 criteria. Accordingly we request that the ACCC reconsider where LMW is placed in the Tier structure.⁸⁷

Also in response to the draft advice, MI stated '[a]nti-discrimination rules should apply to non-member owned operators'⁸⁸. MI further noted:

The use of volume of entitlement as an indicator of the materiality of potential inefficiencies for tier 2 rules should be replaced by another indicator that is related to the extent of the delivery services provided, such as customer numbers, assets and people employed to provide the service.⁸⁹

MI also noted:

The tier 2 rules should be applied to all non-member owned operators to ensure minimum standards for management and efficiency, and to the large member owned operators to underpin those standards (even if they are being met already) and enhance universality.⁹⁰

3.1.6 Support for state regulators rather than the ACCC

The following comments were made in response to the position paper.

The NFF noted:

NFF reiterates its previous position that there is significant support for independent state regulators to continue to undertake this role. NFF urges the ACCC to ensure that state regulators are accredited to undertake Tier 3 determinations.⁹¹

NSWIC noted it 'remain[s] committed to the IPART and believe[s] that IPART ought be the regulator in this state for reasons advanced in our previous submissions'.⁹² In particular it noted:

In responding to who ought be the regulator of the bulk water service providers, NSWIC reiterates its initial submission – IPART has the knowledge, capacity and expertise to regulate prices in NSW. We submit that the ACCC ought set rules whilst IPART retain the obligation to recommend prices.⁹³

⁸⁷ LMW, submission to the ACCC water infrastructure charge rules draft advice, May 2009, p. 2.

⁸⁸ MI, submission to the ACCC water infrastructure charge rules draft advice, June 2009, p. 5.

⁸⁹ *ibid*, p. 7.

⁹⁰ *ibid*, p. 8.

⁹¹ NFF, *op. cit.*, p. 5.

⁹² NSWIC, submission to the ACCC water charge rules position paper, November 2008, pp. 3–4.

⁹³ *ibid.*, p. 4.

The Victorian Government noted:

... the ACCC’s proposed application of the Tier 3 rules should enable this [price approval or determination] function to be carried out by accredited jurisdictional regulators ...

The Victorian Government believes that a process for the accreditation of existing jurisdictional regulators ... should be developed, as required under the IGA [Intergovernmental Agreement on Murray–Darling Basin Reform].⁹⁴

In response to the draft advice, the following comments were received.

NSWIC stated:

NSWIC reaffirms its submission that the NSW IPART [Independent Pricing and Regulatory Tribunal] ought be the body to set price determinations in this state ...

[In relation to consistency] NSWIC again points out that the rules are only applicable where regulated water charges already exist. In the event that no such charge exists, the rules do not apply and “consistency” is not possible.

Moreover, any required “consistency” can, should and ought be delivered by the rules. The rules ought then be adjudicated by a separate body ... the ACCC [should] set the rules and external bodies – such as IPART – should then interpret them.⁹⁵

Gwydir Valley Irrigators Association Inc. (GVIA) noted:

GVIA submits that in keeping with concept of separation of powers the ACCC should licence other bodies (such as IPART in NSW) to be the approver/determiner in keeping with the rules, and the ACCC should carry out the monitoring and compliance role ... existing bodies such as IPART have considerable expertise and knowledge in the area of water charge determinations that should be utilised, rather than spending resources on up skilling the ACCC in the specialist area.⁹⁶

The Victorian Government noted it:

... does not support the ACCC making determinations within Victoria ... this proposed approach could expose regulated water businesses and their customers in Victoria to a range of regulatory, financial and service quality risks ...

The [Victorian] Government does not consider that the ACCC’s draft advice adequately reflects the intent of the *Water Act 2007* (*Commonwealth*), or the Agreement on MDB Reform that the Water Act gives effect to.⁹⁷

Under the ACCC’s proposed approach, regulated operators in Victoria would be required to deal with two regulators in relation to approvals or determinations. [This] ... would increase regulatory complexity, leading to higher regulatory costs and investment

⁹⁴ Victorian Government, submission to the ACCC water charge rules position paper, January 2009, pp. 1–2.

⁹⁵ NSWIC, submission to the ACCC water infrastructure charge rules draft advice, May 2009, p. 8.

⁹⁶ GVIA, submission to the ACCC water infrastructure charge rules draft advice, May 2009, p. 4.

⁹⁷ Victorian Government, submission to the ACCC water infrastructure charge rules draft advice, May 2009, p. 1.

uncertainty that could ultimately result in higher consumer prices and lower levels of service quality for rural water services ...⁹⁸

It also argued that the Essential Services Commission (ESC) in Victoria has considerable experience in regulating Victorian water businesses and proposed the following alternative approach:

... the ACCC's final advice should recognise the expertise and experience of jurisdictional regulators and provide for the ACCC to develop high level principles which accredited jurisdictional regulators would apply in making determinations. Accreditation could be subject to transparent terms and conditions which the ACCC could develop and monitor progress against.⁹⁹

In response to the draft advice, State Water noted:

To provide flexibility for the ACCC to decide whether to undertake a determination or accredit state regulators, State Water believes the rules should include an explicit mechanism for the accreditation of state regulatory bodies and a decision point before each determination when the ACCC or the Minister will inform the operator which regulator will be conducting the determination. This should occur as early as possible in the determination process to give operators certainty regarding which regulatory body will be conducting the determination.¹⁰⁰

3.1.7 Other issues

Schedule 2, clause 3(4) of the *Water Act 2007* (Cwlth) (the Water Act) states:

Water charges in the rural water sector are to continue to move towards upper bound pricing where practicable.

In reference to this, the Queensland Government (in response to the position paper) stated:

This is a key tenet of the National Water Initiative and Queensland's rural water pricing policy. Queensland would ask that explicit consideration be also given to the incorporation of this principle into the water charge rules.¹⁰¹

3.2 ACCC assessment

In determining the form of regulation for the water infrastructure charge rules, the ACCC considered five key issues:

- the need to contribute to achieving the Basin water charging objectives and principles set out in Schedule 2 of the Water Act
- the need to address the underlying market failure

⁹⁸ *ibid.*, p. 2.

⁹⁹ *ibid.* p. 3

¹⁰⁰ State Water, submission to the ACCC water infrastructure charge rules draft advice, May 2009, p. 3.

¹⁰¹ Queensland Government, *op. cit.*, p. 2.

- the governance arrangements of infrastructure operators
- current and historical charging arrangements of infrastructure operators
- the need to ensure that the benefits that accrue from the proposed regulation outweigh any associated costs—including compliance and administrative costs—and, moreover, that the chosen form of regulation offers the highest net benefit compared with all other available options.¹⁰²

The ACCC first considered the extent of the market failure—namely, the misuse of market power—in relation to the provision of water storage and delivery services by infrastructure operators. In this context, it considered the influence of ownership and governance arrangements on the incentives faced by operators to misuse their market power. It then considered what forms of regulation might be warranted, given the extent of the market failure.¹⁰³

3.2.1 What is the market failure?

As explained in the draft advice, the primary market failure justification for regulatory intervention in the rural water sector arises from the natural monopoly characteristics of water infrastructure and the lack of scope for conventional competitive forces. In particular, the infrastructure exhibits substantial economies of scale and consequently it is more economically efficient for there to be a single network servicing a geographically connected area (rather than several networks).

In addition, water storage and delivery infrastructure involve large and lumpy capital investments in long-lived assets. These assets tend to have few alternative uses and the investment, once made, is largely sunk. These characteristics can serve as a barrier to entry, deterring new entrants from entering the market and creating competition.

Taken together, these natural monopoly characteristics mean that direct competition is unlikely to develop between operators. In the absence of competition, water providers hold market power, which can result in prices, quality, service levels or innovation diverging from competitive levels.

In addition, as customers are not able to change service providers without incurring substantial transaction costs,¹⁰⁴ natural monopolies are able to engage in discriminatory behaviour against their customers, certain customer types or potential customers. Such discriminatory behaviour would undermine the efficient use of water resources and water infrastructure.

¹⁰² One of the six principles of good regulatory process of the Regulation Taskforce is that only the option that generates the greatest net benefit for the community, taking into account all the impacts, should be adopted (Regulation Taskforce, *Rethinking regulation: report of the taskforce on reducing regulatory burdens on business*, January 2006).

¹⁰³ In considering the extent of the market failure, the ACCC first determined that all operators, as natural monopolies, hold market power. It then assessed the likelihood of operators misusing this market power, including the effect of ownership arrangements. The size of the operator was then considered to assess the likely overall effect from any potential misuse of market power.

¹⁰⁴ To change providers, irrigators would need to move their business to a different location serviced by a different operator. This is likely to be a costly exercise.

In this context, economic regulation can serve as an alternative mechanism to constrain the scope for monopoly pricing and to maintain incentives to provide an adequate quantity and quality of service. In particular, effective economic regulation should foster efficient pricing, investment and operating practices, and ensure quality of service in the provision of water storage and delivery services.

However, economic regulation is not the only mechanism for constraining monopoly pricing. Other possible mechanisms include joint or ‘club’ ownership of the natural monopoly facilities. Joint or club ownership by irrigators of irrigation infrastructure networks is common. Many irrigation infrastructure operators are structured under cooperative or trust arrangements whereby the irrigators collectively own and operate the irrigation infrastructure networks; these are member owned operators.

3.2.2 Influence of ownership and governance

There are member and non-member owned operators in the MDB. Non-member owned operators tend to be owned by state governments; this is the case for bulk water operators in all Basin states and for irrigation infrastructure operators in Victoria and Queensland. Member owned operators are owned by their member irrigators who hold a share (and corresponding voting rights) in the operator. Irrigation infrastructure operators in New South Wales and South Australia tend to be member owned under a variety of corporate arrangements, including public companies and trusts.

Non-member owned operators

Privately owned¹⁰⁵ natural monopolies generally have the incentives and ability to misuse their market power. In such cases there is generally a strong case for implementing external regulatory controls on price and quality. However, as all non-member owned operators in the MDB are government owned, the incentives are less clear:

- The government, as shareholder, could instruct the directors of the firm to maintain low prices for irrigators, even when this reduces the size of the dividend received by the government.
- The government, as shareholder, could instruct the directors of the firm to maximise long-term profits to maximise the dividend received by the government.

As a general rule, the ACCC takes the view that its regulatory proposals should be ‘blind’ to government ownership. In effect, this assumes that government owned businesses operate in a similar manner to privately owned firms. This approach has the dual advantage that:

- a change of ownership, such as a privatisation, does not necessitate a change in the regulatory framework
- a change in government policy towards maximising long-term profit has no adverse impact on consumers.

¹⁰⁵ In this section the term ‘privately owned’ does not refer to member owned businesses.

This is also consistent with competitive neutrality policies under the National Competition Policy and the Competition Principles Agreement.¹⁰⁶

The case for regulating government owned natural monopolies has also been made in other industries such as in electricity, gas, telecommunications, urban water, wastewater and sewerage. Government owned businesses in these industries are generally subject to price approvals or determinations by an independent economic regulator.

Indeed, a number of state government owned rural water businesses are already subject to price approvals or determinations. State Water, the New South Wales Government owned bulk water service provider, is already subject to price determinations by IPART. Similarly, Victorian rural water businesses have their revenue capped by the ESC.

In summary, it is the ACCC's view that there is a strong case for independent regulatory oversight of non-member owned operators, including those that are government owned.

Member owned operators

Interested parties have submitted varying views on whether member owned operators require formal regulation.

In reference to submissions made by NSWIC and MI, the ACCC notes that the existence of natural monopoly infrastructure in the rural water sector means there is a lack of scope for conventional competition to emerge and these water businesses therefore have inherent market power. None of the submissions has made any argument that refutes the fact that member owned businesses operate infrastructure that is uneconomic to duplicate (that is, these businesses are natural monopolies). This suggests there is an a priori argument for economic regulation.

However, the ACCC recognises that the boards of member owned operators are directly accountable to member customers who are likely to expect efficient pricing and investment and an appropriate level of service. This accountability creates incentives for member owned operators to pursue efficiency in respect of these aspects of service delivery.¹⁰⁷ Indeed, member ownership has been recommended as an effective solution to the problem of natural monopoly infrastructure by the Organisation of Economic Co-operation and Development (OECD)¹⁰⁸ and the New Zealand Institute for the Study of Competition and Regulation Inc (ISCR).¹⁰⁹

¹⁰⁶ For more information see National Competition Council, Government business: competitive neutrality, <http://www.ncc.gov.au/sector.asp?sectorID=16>, viewed 23 September, 2008.

¹⁰⁷ Further, as noted in the position paper, a number of the larger member owned operators are required to comply with the *Corporations Act 2001* (Cwlth) as well as state-based regulation.

¹⁰⁸ OECD 2002, Restructuring public utilities for competition, policy brief, February, p. 4.

¹⁰⁹ ISCR 2007, Using ownership to resolve investment and pricing issues in transmission and distribution, Joint Australia–New Zealand Workshop on Electricity Restructuring, University of New South Wales, 19–20 April.

The ACCC is also aware that member owned operators tend to be non-profit organisations, either explicitly through their constitutions or inherently in the way they operate their businesses. This, along with the fact that member and operator incentives tend to be aligned, means that member owned operators are unlikely to exercise their market power to extract monopoly rents from their member customers. It would appear that NSWIC's reference to 'mirrored competitive behaviour' is a reference to the behaviour of member owned operators. This point has been acknowledged and taken into consideration in forming the ACCC's advice. It is for this reason that the ACCC has in most instances recommended that member owned operators should be subject to less regulatory oversight than non-member owned operators of a comparable size.

However, member owned operators still have the ability to engage in unfair discriminatory conduct against non-member customers. Non-member customers have no voting rights and no ability to influence the actions of the operator or to vote the board out. Further, non-member customers (like all customers) cannot have their service provided by another operator without moving the location of their business and incurring substantial costs, which means the operator retains its market power. Indeed, MI noted that 'if standards drop, our customers ... can remove their investment from the district'.¹¹⁰

Operators have an incentive to discriminate against non-member customers as this could result in lower prices for members. In addition, member owned operators could choose to discriminate against non-member customers to discourage member irrigators from transforming their entitlement. This behaviour could give rise to inefficiencies and potentially distort outcomes in downstream markets.

The ACCC is also concerned that member operators might decide to change their constitutions or business practices to allow member customers to benefit at the expense of non-member customers. In particular, member owned operators could pay excessive distributions to their members as another form of discriminatory behaviour. Indeed, this was the argument put forward by Mark Cameron.¹¹¹

Payment of distributions to investors is not, of itself, a concern. Indeed, the water charging principles of the Water Act include that water charges should move towards upper bound pricing—that is, a level that provides for full cost recovery, including the cost of capital, but avoiding monopoly rents—where practicable.¹¹² However, a move to a for-profit business model creates the opportunity for operators to set their charges at levels greater than those consistent with full cost recovery and for monopoly rents to be returned to members in the distribution of profits.

In summary, the ownership and governance arrangements of member owned operators make it unlikely that these operators will make inefficient charging, service and investment decisions for their member customers. However, these operators still hold

¹¹⁰ MI, loc. cit.

¹¹¹ M Cameron, loc. cit.

¹¹² Schedule 2, clauses 3(5) and (6) of the Water Act.

market power by the nature of their natural monopoly infrastructure and could misuse this market power to discriminate against non-member customers.

For these reasons, the ACCC is recommending that the form of regulation for member owned operators be targeted at ensuring there is no discriminatory pricing towards non-member customers and increasing transparency around infrastructure investment and price-setting processes. Further, where member owned operators choose to pay distributions to their members, the ACCC considers that additional safeguards are warranted.

3.2.3 The three-tiered approach

In addressing the above market failures, the ACCC has considered the Basin water charging objectives and principles¹¹³ and the likely costs and benefits of the different forms of regulation. This has led the ACCC to propose a three-tiered approach:

- Tier 1—rules to ensure there is no discriminatory charging against non-member customers by member owned operators and that fees and charges of all operators are made publicly available.
- Tier 2—rules that require large member owned operators and medium-size non-member owned operators to undertake certain procedural and publishing requirements in determining their charges.
- Tier 3—rules that allow the ACCC to approve or determine regulated water charges for large non-member owned operators.

The tiered approach being proposed is largely consistent with that proposed in the draft advice. Within the tiers, some of the details of the requirements have changed as a result of stakeholder feedback or further policy development by the ACCC. The proposed tiers and their application to each class of operator are discussed below.

3.2.4 Tier 1—non-discrimination and transparency of fees and charges

The primary purpose of the tier 1 rules is to address the issue of discriminatory pricing practices and to improve the transparency¹¹⁴ of fees and charges. The tier 1 rules will ensure that:

- operators publish, or otherwise make available, their schedule of regulated fees and charges
- there is no unwarranted price discrimination by operators against any non-member customers
- where member owned operators pay distributions, regulated fees and charges reflect a rate of return commensurate with the commercial risk involved.

These are discussed below.

¹¹³ Schedule 2 of the Water Act.

¹¹⁴ Schedule 2, clause 2(d) of the Water Act.

Transparency of fees and charges

Under the proposed tier 1 rules, all operators will be required to:

- provide a current schedule of regulated fees and charges to their customers before the end of the three-month transitional period after the rules are registered
- provide a schedule of regulated fees and charges to their customers whenever there are changes to those fees and charges
- provide a schedule of regulated fees and charges to any new customers when they become a customer
- provide a copy of their current schedule of fees and charges to any person who requests it within 20 working days of receiving the request.

Operators servicing more than 10 GL of entitlement will also be required to publish their schedule of fees and charges each time changes are made to those fees and charges, either on their website, in a newspaper (or newspapers) circulated in the region of the operator's network or in the *Commonwealth of Australia Government Notices Gazette* (the Gazette).

One of the Basin water charging objectives is to 'facilitate the efficient functioning of water markets'.¹¹⁵ An efficiently functioning market requires market information to be readily available to market participants. The fees and charges levied by operators are important pieces of information for the water market, allowing potential irrigators to compare regions when deciding where to position their business and also signalling what charges might be levied if an irrigator were to purchase water from a different region.¹¹⁶

Making information on operators' fees and charges readily available to irrigators would also allow irrigators to compare fees and charges across districts. While direct comparisons cannot always be made, this could provide discipline for operators to ensure their charges are appropriate because their irrigator members could question their board about why their charges differ from those of operators in other areas.

Another Basin water charging objective is to 'achieve pricing transparency in respect of water storage and delivery in irrigation systems'.¹¹⁷ Publication of operators' fees and charges should also contribute to achieving this objective.

The ACCC is proposing that the broader publishing requirements should only apply to operators that provide services in relation to 10 GL of entitlement. It might be unduly costly to require small operators to publish their fees and charges online, in a local newspaper or in the Gazette, especially as only the larger operators tend to have their own websites. Instead, small operators would be required to provide such information only to their customers or anyone who requests it. It is expected that only small

¹¹⁵ Schedule 2, clause 2(c) of the Water Act.

¹¹⁶ For example, under tagged trade, there might be different fees levied where the entitlement is purchased from another state.

¹¹⁷ Schedule 2, clause 2(d) of the Water Act.

compliance costs would be involved in meeting these requirements. Indeed, most operators are already likely to be compliant, in which case there would be no additional compliance costs.

The ACCC believes there would be benefit in requiring operators that provide services in relation to more than 10 GL of entitlement¹¹⁸ to distribute information on their fees and charges more broadly. The threshold of 10 GL is expected to capture approximately 23 operators across the MDB, including tier 2 and tier 3 operators.¹¹⁹ The incremental compliance costs of this requirement are expected to be low, especially as most of these operators already provide their schedule of fees and charges on their website. Further, any additional costs are likely to be outweighed by the benefits of increased transparency and improved market information.

The publishing requirements are discussed in more detail in chapter 4.

Non-discrimination

The non-discrimination rules will apply to regulated charges levied on customers¹²⁰ of member owned operators. These rules will prohibit differential pricing towards non-member customers of member owned operators except where differentials reflect differences in actual costs necessarily incurred.

Discriminatory charging against non-member customers is likely to violate a number of the Basin water charging objectives and principles. In particular, discriminatory charging could deter transformation and deter or distort trade¹²¹ or result in operators moving away from user-pays¹²² charging.

The compliance costs of the non-discriminatory pricing rules should be nil or small for operators that do not engage in discriminatory pricing. Therefore, it is the ACCC's view that all member owned operators should be subject to the non-discriminatory pricing rules.

¹¹⁸ Under water access entitlements in the MDB.

¹¹⁹ It is expected that the following operators will be required to publish the schedule of fees and charges on their website, in a newspaper or in the Gazette: State Water, Goulburn-Murray Water, Murray Irrigation Limited, Murrumbidgee Irrigation Limited, Coleambally Irrigation Cooperative Limited, Lower Murray Water, Central Irrigation Trust, SunWater, Jemalong Irrigation Limited, West Corugan Private Irrigation District, Grampians Wimmera Mallee Water, Narromine Irrigation Board of Management, Trangie Nevertire Irrigation Scheme, Western Murray Irrigation Limited, Moira Private Irrigation District, Renmark Irrigation Trust, Tenandra Scheme, Buddah Lake Irrigators, Abercrombie Pumping Association, Eagle Creek Pumping Syndicate, Coliban Water, SA Water and Hay Private Irrigation District.

¹²⁰ Rural customers include irrigators, stock and domestic users and private diverters.

¹²¹ One of the Basin water charging objectives is to facilitate the efficient functioning of water markets (Schedule 2, clause 2(c) of the Water Act). This requires irrigators to be able to transform and trade entitlements with minimal deterrents or distortions.

¹²² Schedule 2, clause 2(d) of the Water Act.

As discussed above, member owned operators could also discriminate against their non-member customers through the payment of distributions or the provision of a financial benefit to their members.

Such discriminatory behaviour cannot be addressed through the non-discriminatory pricing rules and therefore an additional safeguard is required for these operators. In particular, for member owned operators paying a distribution to their member customers, the ACCC is proposing that it approve or determine the operator's charges. However, such an approval or determination would be limited to considering the rate of return used by the operator to set the level of charges and whether the proposed charges would contribute to achieving the Basin water charging objectives and principles.

In recommending this approach the ACCC is mindful of considering what impact such behaviour could have on water users and the ability of these operators to comply with the proposed approval or determination process. In applying proportionate regulation, the ACCC considers that the size of an operator's business (as well as its ownership arrangements) is an important factor in determining the appropriate regulatory response. Therefore, the ACCC is recommending that only member owned operators of sufficient size—where the total volume of entitlement¹²³ to which the operator and its customers are entitled within the MDB exceeds 10 GL—that pay a distribution to their members be subject to these requirements (appendix 1).¹²⁴

The non-discriminatory charging requirements are discussed in more detail in chapter 4.

Tier 1 rules are contained in Parts 2, 3, 4 and 7 (and Schedule 3) of the draft rules.

3.2.5 Tier 2—procedures for determining regulated water charges

The tier 2 rules will apply where approvals and determinations are not considered appropriate—given ownership arrangements and the size of an operator—and where the operator is of substantial size and an additional level of regulation, above the tier 1 rules, appears appropriate. It is noted that the tier 2 requirements will be in addition to the tier 1 requirements discussed above.

The proposed rules will require operators to:

- develop a network consultation paper (NCP) that details options for the operator's network over a five-year period¹²⁵
- consult with customers about the NCP
- develop a network service plan (NSP) that builds on the NCP consultation process and details major capital works and associated expenditure over a five-year period

¹²³ Under water access entitlements.

¹²⁴ This requirement is expected to capture the member owned operators referred to in footnote 96 if these operators introduce distribution payments to their member customers.

¹²⁵ The five-year period should be the five years commencing from the start date of the network service plan (that is, the next five years).

- provide the ACCC with the NSP so that the ACCC can engage an external engineering consultant that has experience in working with water infrastructure assets to review the NSP
- provide customers with a copy of the NSP
- provide customers with a copy of the engineer's review once this has been provided by the ACCC
- publish a schedule of fees and charges before those fees and charges come into effect (in line with the tier 1 requirements)
- each time charges are to change, develop and provide customers with a copy of an information statement that outlines any changes in charges from those anticipated in the NSP.

These requirements are discussed in more detail in chapter 5.

Effective implementation of the tier 2 rules should contribute to achieving the following Basin water charging objectives and principles:

- Promoting the economically efficient and sustainable use of water resources and water infrastructure assets.¹²⁶

The tier 2 rules should ensure that there is rigour around an operator's asset planning processes, including an external engineer's review of the NSP. This should contribute to achieving efficient investment in water infrastructure assets. In addition, customers will have access to more information and will be better able to make decisions about efficient water use and complementary 'on farm' investments.

- Ensuring sufficient revenue streams to allow for the efficient delivery of the required services.¹²⁷

Requiring operators to revisit asset planning and charges at least every five years will ensure these businesses are constantly updating their estimates to reflect current market and other conditions. This should ensure that operators continue to recover sufficient revenue even under changing market conditions. In addition, because an external engineering consultant will review the operator's NSP, this should identify whether the operator is likely to recover sufficient revenue.

- Facilitating the efficient functioning of water markets.¹²⁸

An efficient market relies on adequate information being readily available to market participants. The tier 2 requirements should increase and improve the information made available to customers of tier 2 operators.

- Achieving pricing transparency in respect of water storage and delivery in irrigation systems.¹²⁹

¹²⁶ Schedule 2, clauses 2(a)(i) and (ii) of the Water Act.

¹²⁷ Schedule 2, clause 2(b) of the Water Act.

¹²⁸ Schedule 2, clause 2(c) of the Water Act.

The NSP and information statement will improve pricing transparency of tier 2 operators. This information will allow customers to understand the reasons for the levels of charges, including any price differentials and reasons for those differentials.

- Avoiding perverse or unintended pricing outcomes.¹³⁰

Ensuring customers are consulted in the development of an NSP should limit the potential for perverse or unintended pricing outcomes resulting from an operator not representing its customers' preferences. In addition, the information statement will explain the level of charges, which should limit the number of complaints received in relation to the non-discriminatory pricing rules.

In addition to contributing to the Basin water charging objectives and principles, the information made available under the tier 2 rules will provide a good basis for monitoring and enforcing the water charge rules. The information statement, in particular, should highlight instances of discriminatory pricing and will provide a first source of information to customers and operators about reasons for any charging differentials. This should reduce compliance costs associated with investigating unfounded complaints of discriminatory charging.

The application of the tier 2 rules to member and non-member owned operators is discussed below.

Application to member owned operators

For member owned operators, the tier 2 rules are intended to complement existing governance arrangements to further contribute to achieving the Basin water charging objectives and principles. The tier 2 requirements will provide adequate information—on the level of charges, service and investment being proposed by operators—to allow members to make informed decisions when exercising their voting rights.

However, the tier 2 requirements could be unduly costly for smaller operators. For these operators, it is uncertain that the benefits associated with this form of regulation would outweigh the costs.

In comparison, larger member owned operators have increased capacity to comply with these requirements. Indeed, many of these operators already undertake similar processes in determining their asset investment, service levels and associated charges (section 5.3.1). For example, a number of operators already undertake customer consultation and prepare asset management plans (which have many elements in common with NSPs). Hence, their incremental costs should be relatively low. In addition, these businesses service a large portion of the MDB, meaning their influence is substantial and the case for an additional layer of regulation above the tier 1 rules is strong.

¹²⁹ Schedule 2, clause 2(d) of the Water Act.

¹³⁰ Schedule 2, clause 2(e) of the Water Act.

For these reasons, the ACCC is recommending that the tier 2 requirements apply to member owned operators where the total volume of entitlement to which the operator and its customers are entitled within the MDB exceeds 125 GL. Under current arrangements, it is expected that this will capture Murray Irrigation Limited, Murrumbidgee Irrigation Limited, Coleambally Irrigation Cooperative Limited and Central Irrigation Trust (appendix 1).

Application to non-member owned operators

Larger non-member owned operators are recommended to be subject to the tier 3 requirements (see below). However, the ACCC believes that the case for making all non-member owned operators subject to approvals or determinations is weak. In particular, in assessing what types of operators should be subject to the various forms of regulation, the ACCC has aimed to recommend regulation that is proportionate to the problem (or market failure) being addressed.

In applying this framework, the ACCC believes that only the larger non-member owned operators should be subject to tier 3 rules. Similarly, the ACCC believes that some non-member owned operators are too small—in terms of their rural activities within the MDB—to justify any regulation above that required under tier 1.

For these reasons, the ACCC recommends that tier 2 requirements should apply only to predominantly non-member owned operators where the total volume of entitlement to which the operator and its customers are entitled within the MDB exceeds 125 GL but is less than 250 GL. Under current arrangements, it is expected that this will capture SunWater.

Tier 2 rules are contained in Part 5 of the draft rules.

3.2.6 Tier 3—approval or determination of water charges

Under tier 3, relevant operators will be required to seek regulatory approval for their charges over a defined regulatory period. The regulator will then assess the charges against certain criteria to determine whether to approve or determine the charges. It is noted that the tier 3 requirements will be in addition to any relevant requirements under tier 1.

The tier 3 rules will include:

- the pricing principles to be used in approving or determining the level of charges
- the information that will be required from operators
- the processes that are to be followed by the regulator and regulated operators in having regulated water charges approved or determined
- any transitional arrangements.

These are discussed in more detail in chapter 6.

Of the possible regulatory options, the approval or determination of water charges is the most likely to contribute to achieving the Basin water charging objectives and

principles because it will give the regulator the ability to determine charges specifically with these objectives in mind. Moreover, it is the most likely to constrain market power, result in consistent water charging practices across the MDB and improve transparency. Therefore, it is likely to have the highest benefits compared with other regulatory options. However, it is a potentially costly option and should only apply where an operator's governance arrangements do not limit the potential for misuse of market power and where an operator is large enough that the potential impact warrants further regulation.

As discussed, non-member owned operators are the least likely to have incentives to constrain their market power. However, given the costs of an approval or determination process, the ACCC believes that only sufficiently large non-member owned operators—where the total volume of entitlement to which the operator and its customers are entitled within the MDB exceeds 250 GL—should be subject to tier 3 rules (appendix 1). Only these larger businesses have the potential to affect a significant portion of water users and have the resources required to comply with an approvals or determination process.

In its submission to the position paper, IPART recommended that all non-member owned operators should be subject to tier 3 rules. IPART also recommended:

... an operator's proposal should be subject to significant regulator scrutiny and review ... in practice a regulator should scrutinise a utility's proposal (along with other sources of information) to *determine* rather than merely *approve* required revenue and prices.¹³¹

IPART also stated:

... the ACCC's expectations regarding the level of information provided by SunWater and the resources that the ACCC devotes to the determination of SunWater's prices could be significantly less than a determination of prices for a larger bulk water supplier in the Basin, such as State Water.¹³²

This second statement recognises that regulation should be proportionate and that when determining the appropriate regulatory framework, the size of an operator's business is an important consideration. However, as stated by IPART, in practice a regulator is likely to scrutinise an operator's pricing application and will likely determine rather than approve its prices.

To be satisfied that an operator's proposed charges contribute to achieving the Basin objectives and principles, the ACCC will require detailed information from the operator and adequate internal resources. In this way, the ACCC considers that a scaled-down approval or determination requirement would undermine the integrity of the tier 3 requirements and would not effectively contribute to the Water Act's objectives and principles, even for smaller non-member owned operators. Where an operator is not large enough to justify the costs of a rigorous approval or determination process, it should instead be subject to tier 1 or tier 2 rules.

¹³¹ IPART, submission to the ACCC water charge rules position paper, November 2008, p. 5.

¹³² *ibid.*

Only where a non-member owned operator is significantly large in the context of the MDB as a shared resource does the ACCC recommend it be included under tier 3. Under current arrangements, this would include State Water, Goulburn-Murray Water (GMW) and LMW.

The ACCC recognises that the majority of LMW's rural services are provided to private diverters. While the ACCC understands that these charges are set by GMW, LMW still provides a non-contestable service and hence LMW has scope to price above those pass through charges. Therefore, the ACCC maintains that all water to which a regulated charge applies should be included for the purposes of determining to which tier an operator will be subject.

Tier 3 rules are contained in Part 6 (and Schedules 1 and 2) of the draft rules.

3.2.7 Should the rules provide for accreditation of state agencies to undertake approvals or determinations?

Under s. 92 of the Water Act, the minister may make water charge rules that provide for the ACCC to:

- approve or determine regulated water charges and/or
- accredit arrangements under which regulated water charges are determined or approved by agencies of the states.

This latter option would appear to provide for the accreditation of a state agency to approve or determine an operator's charges under the water infrastructure charge rules. For example, ESC or IPART would be accredited to approve or determine regulated charges for operators in their respective states under Part 6 and/or Part 7 of the water infrastructure charge rules.

The ACCC notes that the mechanism to achieve this does not currently exist—it would likely require the relevant state to enact legislation providing for the state agency to perform the functions under Part 6 and/or Part 7, and to confer any other necessary or incidental powers onto the state agency.

In addition, ss. 92(3) of the Water Act provides that, in relation to accreditation, the rules may deal with:

- the process to be followed in applying for or giving accreditation¹³³
- the terms and conditions on which arrangements are accredited (including the determination of some or all of those terms and conditions by the ACCC)¹³⁴
- the obligations to be imposed in relation to the accreditation of arrangements (including the determination of some or all of those obligations by the ACCC).¹³⁵

¹³³ Section 92(3)(f) of the Water Act.

¹³⁴ Section 92(3)(g) of the Water Act.

¹³⁵ Section 92(3)(h) of the Water Act.

Subsection 92(6) of the Water Act further provides that the rules dealing with accreditation may provide for the circumstances in which an accreditation may be revoked or the terms and conditions on which an accreditation may be varied.

Therefore, the rules may provide for either the ACCC or accredited state agencies to approve or determine regulated charges. This is reflected in the Revised Explanatory Memorandum to the Water Act and the Intergovernmental Agreement on Murray-Darling Basin Reform.

The purpose of this section is to assess whether the rules should include provisions to accredit arrangements under which regulated water charges are determined or approved by state agencies. This assessment is made in the context of:

- achieving the Basin water charging objectives and principles
- undertaking monitoring and enforcement of the rules
- the ACCC's capability
- issues raised by interested parties.

Assessment against the Basin water charging objectives and principles

The water charge rules are required to contribute to achieving the basin water charging objectives and principles set out in Schedule 2 of the Water Act. The ACCC is of the view that in advising the minister on water charge rules, its role is to recommend rules that will best contribute to achieving those objectives and principles. The purpose of this section is to assess which of the options available under the Water Act for the tier 3 rules would best contribute to achieving the Basin water charging objectives and principles.

The Basin water charging objectives and principles are contained in Schedule 2 of the Water Act and are reproduced in appendix 3. It is difficult to assess whether having the ACCC or multiple state agencies undertake approvals or determinations would better contribute to achieving a number of these objectives and principles. For example:

- ensuring operators recover sufficient revenue—all economic regulators could presumably contribute to achieving this
- giving effect to the principles of user-pays and pricing transparency—all economic regulators could presumably contribute to achieving this
- inclusion of a consumption-based component in charges—all economic regulators could presumably contribute to achieving this
- full cost recovery and reporting of any subsidies—all economic regulators could presumably contribute to achieving this.

However, there are certain Basin water charging objectives and principles that the ACCC considers could be best achieved with a single MDB regulator undertaking approvals or determinations across the MDB. In particular, this would better achieve consistency and the efficient use of water resources, investment in water infrastructure and water trade.

Consistency in charging across jurisdictions where water can be traded¹³⁶ is an important prerequisite for an efficient water market.¹³⁷ Water charges send signals about the efficiency of water storage and delivery infrastructure across the Basin. Where Basin jurisdictions pursue different charging practices, this can distort these signals, which in turn can distort the water market. If there are distortions to the water market, this will result in less efficient water use and investment in water related infrastructure. Clearly such outcomes are at odds with the Basin water charging objectives and principles, including the efficient and sustainable use of water resources and water infrastructure assets¹³⁸ and the efficient functioning of water markets.¹³⁹ In this way, consistency in charging is an important prerequisite for efficient and effective water markets and the efficient use of water resources and investment in water infrastructure assets.

The goal of achieving a consistent Basin-wide approach is reflected in the Water Act. An overarching intent of the Water Act appears to be to move towards a basin-wide—or, indeed, national—approach to water resource management. The revised explanatory memorandum for the Water Act states:

The Bill will enable water resources in the Murray-Darling Basin to be managed in the national interest, optimising environmental, economic and social outcomes.¹⁴⁰

In relation to the ACCC's functions:

The Bill provides the ACCC with a key role in developing and enforcing water charge and water market rules along the lines agreed in the National Water Initiative. The aim of these new functions is to ensure that water markets are able to operate freely across state boundaries and that perverse outcomes from inconsistent water charging arrangements are avoided.¹⁴¹

Further, the objects of the Water Act include:

- (a) to enable the Commonwealth, in conjunction with the Basin States, to manage the Basin water resources in the national interest; and ...
- (f) to ensure that the management of the Basin water resources takes into account the broader management of natural resources in the Murray-Darling Basin; and
- (g) to achieve efficient and cost effective water management and administrative practices in relation to Basin water resources ...¹⁴²

¹³⁶ Schedule 2, clause 3(7) of the Water Act.

¹³⁷ Schedule 2, clauses 2(c) and 3(1) of the Water Act.

¹³⁸ Schedule 2, clause 2(a) of the Water Act.

¹³⁹ Schedule 2, clauses 2(b) and 3(7) of the Water Act.

¹⁴⁰ Revised Explanatory Memorandum, *Water Act 2007*, (Cwlth), p. 4.

¹⁴¹ *ibid.*, p. 3.

¹⁴² Section 3 of the Water Act.

The ACCC is of the view that a consistent Basin-wide approach to charging will have the greatest efficiency benefits in terms of providing the basis for an efficient and effective water market. The ACCC is also of the view that having one regulator responsible for administering the water charge rules across the entire Basin will be the least costly way of achieving a consistent approach to water charging across the Basin.

This approach is also the best able to achieve consistency in a dynamic sense. If operators that are not currently subject to independent price regulation become subject to the tier 3 rules, there will not necessarily be an obvious candidate for accreditation. This could occur if states chose to opt in to whole-of-state coverage by the rules or if operators that do not currently levy charges introduce charges. Under such circumstances, it would appear that having a national regulator responsible for regulating all tier 3 operators would be the most sensible approach to achieving consistency in charging by tier 3 operators.

The single regulator model for economic regulation has been adopted in other sectors where there is trade across state jurisdictions. For example, regulation of the electricity market has moved from a state-based approach to a national approach applied by a single national regulator—the Australian Energy Regulator.

This type of model was also advocated in the Hilmer report as part of the first wave of microeconomic reforms in Australia. The Hilmer Report noted:

Responses to monopoly pricing issues can also involve inter-State or national implications in some circumstances. Even where the pricing issues are predominantly within a single State, there may be advantage in developing nationally-consistent approaches to many issues, as well as in progressing pricing reforms in particular sectors in a coordinated way.¹⁴³

Two submissions¹⁴⁴ argued that consistency could be achieved even with different regulators being responsible for approving or determining charges in each MDB state. The ACCC recognises that having different regulators operate under the same set of rules would most likely constitute a move towards a more consistent Basin-wide approach. However, as with all economic regulation of infrastructure, the final decision on price and revenue caps remains with the regulator.

The rules have been designed to provide clarity and predictability for the regulated businesses. Nevertheless, and consistent with economic regulation of infrastructure in other sectors, the proposed rules must leave a degree of discretion for the regulator to assess the individual circumstances of each business. Differences in the application of the rules across regulators would likely result in some inconsistency across the Basin even if the same rules are applied.

To maximise consistency with multiple regulators, the following types of measures would need to be included in the rules or the terms, conditions or obligations of accreditation:

¹⁴³ FG Hilmer, M Rayner, and G Taperell, *National Competition Policy*, 1993, AGPS, Canberra, p. 16.

¹⁴⁴ NSWIC, submission to the ACCC water infrastructure charge rules draft advice, May 2009, p. 8 and Victorian Government, submission to the ACCC water infrastructure charge rules draft advice, May 2009, pp. 1–3.

- Accredited state agencies would need to undertake determinations or approvals in accordance with Parts 6 and 7 of the rules so that all regulators would be applying the same set of rules for approving or determining regulated charges.
- State legislation would need to be amended to allow accredited state agencies to apply the water infrastructure charge rules and to provide those state agencies with the same powers as are available to the ACCC under the Water Act.
- All regulators (the ACCC and accredited state agencies) would be required to follow the same guidelines in applying the rules. These would be developed by the ACCC.
- Some common elements of the building block approach might need to be determined and applied consistently by the relevant regulators (for example, the weighted average cost of capital and the regulatory asset base). These could be determined by the ACCC.

As discussed above, the ACCC considers that such an approach is second best as it will still leave some inconsistency. It is also more likely to result in a more prescriptive and complex regulatory model as compared with a single MDB-wide regulator model. An approach with multiple regulators implementing the water infrastructure charge rules is also likely to generate greater regulatory and compliance costs compared with an approach with one regulator responsible for approvals or determinations across the Basin. This last point is discussed in more detail in the following section.

These things considered, the ACCC believes that having one regulator responsible for approving or determining charges across the Basin will be the most efficient and effective way of achieving the objectives and principles of the Water Act.

Monitoring and enforcement

The ACCC has a monitoring and enforcement role under s. 94 of the Water Act. There will be obvious synergies in having the ACCC responsible for the monitoring and enforcement of the water charge rules and water market rules and having it responsible for undertaking approvals and determinations. Alternatively, with accreditation of state agencies, the operator would have to deal with both the state agency in respect of its price approval or determination and the ACCC in respect of monitoring and enforcement of the water charge rules.

Much of the information required for the monitoring and enforcement of the tier 3 rules will be made available to the regulator as part of the approval or determination process. If the regulator were the ACCC, it would mean that this information could be gathered as part of the approval or determination process, saving the operator from separately providing the information to the ACCC. Because of this, administrative and compliance costs are likely to be greater under accredited arrangements than under an approach where the rules are administered, monitored and enforced by one agency.

The information gathered as part of the approval or determination process will also be used for the monitoring and enforcement of the tier 1 rules, the termination fees rules and, to some extent, the market rules. Again, having the ACCC responsible for approvals or determinations is likely to minimise the administrative and compliance costs faced by the operator and the regulator.

Under an accreditation framework, there would need to be an overlay of monitoring to ensure that all accredited agencies are applying the rules consistently and that operators are complying with the rules. This could involve:

- the operator or accredited state agency providing copies of all documents received as part of the approval or determination process to the ACCC
- the accredited state agency monitoring and reporting to the ACCC on compliance by the regulated entity with the rules.

The ACCC has limited options for enforcing compliance by state agencies. Although the ACCC could revoke an accreditation where a state agency failed to comply with terms and conditions of that accreditation, this would raise issues about what would happen to an existing approval or determination made by that agency. This could lead to perverse outcomes including increased uncertainty for the regulated business and its customers.

ACCC's capability

The ACCC has extensive expertise in regulating various natural monopolies in other industries. In addition, the ACCC has considerable resources available for the regulation of water charges. The ACCC will be able to apply this expertise and capability to regulating rural water charges.

The ACCC notes that IPART and the ESC have considerable experience in regulating rural water businesses. The ACCC, in developing its advice to the minister, has had regard to the processes of these regulators and recommends an approach that builds on the progress made to date by these agencies. The ACCC has also recommended transitional arrangements in moving from a state-based approach to a Basin-wide approach. This transitional period will provide the ACCC with adequate time to improve its industry knowledge and to learn from the experiences of IPART and the ESC.

All of the tier 3 operators that would be subject to price regulation are wholly owned by state governments. The boards of these businesses are appointed by the relevant state government minister and the businesses pay dividends to the state governments. There is an inherent conflict between a state government's interests as an owner of the operators and its interests in regulating them. As a national regulator the ACCC has no such conflict of interest in regulating the state government owned tier 3 operators. If state-based regulators were to undertake the regulatory task, additional safeguards and separations would be required to ensure these regulators could fully exercise their independence.

Furthermore, as a national regulator, the ACCC is required to consider the interests and welfare of all Australians. This aligns with the object of the Water Act being to manage MDB resources in the national interest. In contrast, state regulators are generally only required to consider the interests or welfare of consumers within their state. For example, the objects of the *Essential Services Commission Act 2001* (Vic) include:

In performing its functions and exercising its powers, the primary objective of the Commission [ESC] is to protect the long term interests of Victorian consumers with regard to the price, quality and reliability of essential services.¹⁴⁵

Specific issues raised by interested parties

A number of interested parties¹⁴⁶ have supported state regulators retaining responsibility for the regulation of larger non-member owned operators.

In their submissions to the draft advice, the NSWIC and GVIA recommended that state regulators should be responsible for undertaking approvals or determinations to ensure proper ‘separation of powers’. These comments have been made on the assumption that the ACCC is making the rules and hence it should not also be responsible for administering the rules. The ACCC notes that it is the minister rather than the ACCC that will make the water charge rules. The ACCC’s role is to provide advice to the minister on the rules and to monitor and enforce the rules. The ultimate decision as to the content of the rules lies with the minister.

The ACCC notes the concerns of the NSWIC that the rules cannot achieve consistency due to their limited applicability to operators that levy regulated charges. However, the ACCC does not believe that this limitation should lead the ACCC to dismiss the goal of consistency. The ACCC’s role is to recommend the approach with the highest net benefit and which best contributes to achieving the Basin water charging objectives and principles within the constraints of the Water Act.

State Water suggested that the rules should provide for the option of accreditation. Prior to each new regulatory period, the ACCC or the minister would then decide whether the ACCC or an accredited state agency would undertake the next approval or determination process. The ACCC is concerned that such an approach would provide little regulatory certainty to the operator or to the regulator(s). In addition, it is likely to have higher compliance costs due to differences in approach between the two regulators and potentially having to adapt to each of these approaches every three to four years. From an administrative point of view, the ACCC also believes that it would be inefficient for both the ACCC and state agencies to maintain sufficient resources to undertake approvals or determinations where the task would only fall to one of these agencies each time. In sum, such an approach would likely impose additional costs and uncertainty for minimal additional benefit.

The Victorian Government argued that the minister should accredit the ESC to apply the water charge rules. It argued that accreditation would reduce regulatory overlap and duplication. Since the ACCC cannot regulate urban water charges, LMW will be regulated by both the ESC and the ACCC. Similarly the Victorian Government proposes retaining quality of service regulation, in which case two regulators would be involved in regulating the tier 3 operators: the ESC would set service standards and the ACCC would approve or determine regulated charges.

¹⁴⁵ Section 8(1) of the *Essential Services Commission Act 2001* (Vic).

¹⁴⁶ For example, GVIA, NFF, NSWIC and the Victorian Government.

The ACCC recognises that its proposed approach would result in LMW having its business regulated by the ACCC in relation to its rural activities and the ESC in relation to its urban activities.

The Water Act introduces a new regulatory framework for the regulation of rural water charges across the MDB. The ACCC acknowledges that in pursuing consistency across the MDB there may be less consistency of approach across rural and urban water services and in relation to the regulation of service standards.¹⁴⁷ However, the ACCC is of the view that any additional costs imposed due to these differences in approach will be outweighed by the market benefits, in terms of efficiency and trade, of moving to a single Basin-wide regulator. A consistent approach in the rural sector is particularly important given that rural water markets extend across state boundaries.

The ACCC also notes that accreditation will only partly address the problem. LMW will still operate under two regulatory frameworks, two regulatory processes and two regulators. The two regulatory frameworks will be the existing state provisions for the urban services, and the water charge rules for the rural services. There will still be one price review process for urban services, and another for rural services. Since the ACCC will continue its monitoring and enforcement functions in respect of the water charge rules and water market rules, there will still be two regulators.

If the ACCC regulates LMW's rural services, there is scope to streamline the regulatory process. LMW's business is already divided into urban and rural activities. The ACCC would operate within the ESC's existing cost allocation framework in approving or determining LMW's rural charges, and would work cooperatively with the ESC to incorporate any changes to this methodology into the future. In addition, the ACCC is recommending rules that will allow for the timing of the urban and rural price setting processes to be aligned. This alignment will minimise much of the additional costs arising from having separate agencies determining LMW's rural and urban charges.

In relation to service standards, the ACCC notes that the Victorian Government can address duplication arising from quality of service assessments by leaving the ACCC to set quality of service standards and incentives as part of its price determination process. While the Water Act does not provide explicit provisions for the determination and monitoring of service standards, the ACCC could formulate service standards and monitor these service standards in cooperation with the operators, based on the existing model employed by the ESC. This approach would not impose any additional costs on the ESC or the Victorian operators.

Alternatively, if the Victorian Government wants the ESC to set quality of service requirements, the ACCC would take these as inputs to the approval or determination process, similar to the inputs received from other technical regulators.¹⁴⁸ To this end,

¹⁴⁷ The ACCC notes that even if the ESC were to regulate urban and rural water charges and service standards for Victorian operators, the regulation of rural water charges would still be under a separate regulatory framework, meaning that some additional compliance costs would inevitably arise even under this model.

¹⁴⁸ For example, the Environment Protection Authority.

the ACCC and the ESC would be required to align the timing of these processes but this is unlikely to impose any additional costs on the ESC or the Victorian operators.

Summary

In relation to the tier 3 rules, the ACCC believes that the objectives and principles of the Water Act¹⁴⁹ can be best achieved through a single regulator being responsible for approvals or determinations across the MDB. This approach will be best able to ensure consistency¹⁵⁰ in the approach to setting charges across the MDB. This in turn will facilitate freer water markets¹⁵¹ and more efficient use of water resources and investment in water infrastructure.¹⁵² It will also have benefits in relation to the monitoring and enforcement of the rules. Further, the ACCC believes that a national regulator will have more ability to act in the interests of the basin as a whole rather than in the interests of a particular jurisdiction.

The ACCC considers that, on balance, this approach will offer the highest net benefit compared with an approach where multiple regulators are responsible for undertaking approvals or determinations. With accredited state agencies undertaking approvals or determinations there is likely to be:

- less consistency of approach, leading to efficiency losses in the water market and in the use of water resources and investment in water infrastructure assets
- greater compliance costs as there will be two regulators: the state agency in respect of approving or determining water charges and the ACCC undertaking its enforcement and monitoring role under the Water Act
- higher administrative costs associated with enacting the required state legislation to provide that state agencies can operate under the water infrastructure charge rules and to provide those agencies with the same powers as are available to the ACCC under the Water Act.

In comparison, the ACCC believes that a single Basin-wide regulator administering the water infrastructure charge rules would provide a greater net benefit and that this approach would better contribute to achieving the Basin water charging objectives and principles. Therefore, the ACCC recommends that the rules should not include provisions to accredit arrangements under which regulated water charges are determined or approved by state agencies. The ACCC considers that the single Basin-wide regulator model is the first best approach in achieving the objectives under the Water Act.

Nevertheless, if the minister still considered it necessary to provide for accreditation provisions in the water infrastructure charge rules, it would be necessary for such rules to be subject to further consultation.

¹⁴⁹ Schedule 2 of the Water Act.

¹⁵⁰ Schedule 2, clause 3(7) of the Water Act.

¹⁵¹ Schedule 2, clauses 2(c) and 3(7) of the Water Act.

¹⁵² Schedule 2, clause 2(a) of the Water Act.

Given the issues identified above, the rules or the terms, conditions or obligations under which an accreditation is given should fundamentally ensure the complete independence, capacity and mandate of state regulators to undertake approvals and determinations under the water infrastructure charge rules in a way that achieves the objectives of the Water Act, including promoting the interests of the Basin as a whole. In practice this will require a highly prescriptive framework, either through the format of the rules themselves or the associated terms, conditions and obligations under which accreditation is granted. For example, the additional safeguards as part of accreditation would, at the very least, need to include the following types of requirements:

- the state agency must undertake determinations or approvals in accordance with Parts 6 and 7 of the rules
- the relevant state must enact legislation to provide for the relevant state agency to:
 - apply Parts 6 and 7 of the water infrastructure charge rules
 - exercise the same powers necessary for the performance of this function as are available to the ACCC under the Water Act
- the state agency must follow the guidelines determined by the ACCC in applying the rules
- the state agency must apply those elements of the building block that have been determined by the ACCC
- the state agency, in undertaking determinations or approvals, must do so in the interests of the Basin as a whole rather than in the interests of the state
- the state agency must provide the ACCC with copies of the information that the state agency receives in respect of Parts 6 and 7 of the rules
- the state agency must monitor and report to the ACCC on compliance by the regulated entity with Parts 6 and 7 of the rules
- the state agency must be independent from the bodies being regulated
- the state agency must not be subject to the direction of the relevant state minister in respect of Parts 6 and 7 of the rules
- there must be a process for revocation in the event that these requirements are not satisfied.

Furthermore, the accreditation rules and associated process for accreditation should be reviewed as part of the overall review of the water charge rules.

3.2.8 Movement between the tiers

IPART recommended that there should be scope to move operators between the tiers depending on compliance.

As the ACCC is proposing a new regulatory framework to apply to the MDB as a whole, one of its key objectives is to provide regulatory certainty to regulated parties and their customers. For this reason, the ACCC recommends that the thresholds for inclusion under the tiers should remain fixed. These should then be assessed for appropriateness as part of a comprehensive review of the water charge rules (below).

This will provide operators and their customers with greater regulatory certainty and will limit the compliance costs associated with switching between tiers. In addition, the Water Act provides for mechanisms to enforce compliance (see chapter 7). These measures should be sufficient to encourage compliance with the water charge rules without creating additional regulatory uncertainty.

However, the ACCC recognises that even with unchanging criteria for the application of the tiers to the various operators, some operators could move between the tiers. For example, two tier 1 operators could merge and the merged business could be large enough to be captured under the tier 2 rules. Therefore, the rules must specify the requirements on operators in moving from one tier to another. Transitional arrangements for tiers 2 and 3 will be discussed in chapters 5 and 6.

3.2.9 Review of the water charge rules

Section 253 provides for a review of the operation of the Water Act—and the extent to which the objectives and principles of the Water Act have been achieved—to be undertaken at a time to be determined by the minister, before the end of 2014.

The ACCC considers that such a review will be important in assessing:

- the extent to which the water charge rules are contributing to achieving the Basin water charging objectives and principles
- whether the ACCC's assumptions underpinning the form of regulation for the water charge rules remain valid.

In addition, a review is important because the rural water sector is in a period of change, including as a result of:

- further liberalisation of transformation and water trading
- the extended drought and climate change
- the development of the Basin Plan
- the government's programs of water purchases and irrigation infrastructure modernisation.

The specific timing of any review is influenced by the ability to collect sufficient information. The information requested from operators under the tiered approach should provide a good base level of information from which to assess the effectiveness of the water charge rules. However, the ACCC considers that any review would require a number of years of information to be gathered on the impact of the water charge rules. The ACCC also notes that, with the proposed transitional arrangements, the water charge rules will not be fully implemented before 2014.

4 Transparent and non-discriminatory pricing

The tier 1 rules require operators to publish their fees and charges and prohibit discriminatory pricing between member and non-member customers. The rules are to apply to all operators, including those also subject to tier 2 or tier 3 rules.

The purpose of the publishing requirement is to improve transparency and to provide market information. Schedules of regulated water infrastructure charges should provide sufficient detail to enable a customer to calculate water delivery costs and to make comparisons with other valleys, regions or market segments.

The non-discrimination rule will promote the efficient use of water resources and infrastructure assets. The non-discrimination requirements will permit differential pricing where this aids efficiency or contributes to the objectives and principles of the *Water Act 2007* (Cwlth) (the Water Act). However, the requirements will prohibit differentials based on unfair discrimination against non-member customers of member owned operators.

The draft tier 1 rules provided with this advice are in line with the proposals made in the draft advice, and are informed by views received from interested parties in submissions to the position paper and the draft advice and rules. The ACCC has had regard to current governance and charging arrangements, and the rules are designed to contribute to the objectives and principles of the Water Act.

4.1 Information on regulated water charges to be published

The proposals contained in the draft advice and rules for tier 1 publication of regulated water charges were as follows:

- All operators are required to provide a schedule of their regulated fees and charges to their customers within three months of the rules taking effect and, subsequently, one month before changes to charges take effect.
- The schedule is required to:
 - provide details of the fees and charges, including fixed and variable components of charges, for regulated water charges
 - include sufficient information to enable a customer to calculate their total bill based upon an estimate of demand
 - show any rate differentials applying across regions or customer segments within the operator's network
 - include details of discounts, rebates or surcharges, and the circumstances in which they apply.
- Operators above a 10 GL water threshold will also be required to publish their schedule of fees and charges in a paper circulated in the region of network

operation or in the *Commonwealth of Australia Government Notices Gazette* (the Gazette) at the time new charges come into effect.

4.1.1 Views of interested parties

Four submissions¹⁵³ received in response to the position paper specifically endorsed the requirement to publish regulated fees and charges annually. Submissions also noted that many operators' current practices comply with this requirement.

Western Murray Irrigation (WMI) advised:

The current format of the WMI schedule complies with the ACCC requirements and is publicly available. It is also provided to every customer of WMI.¹⁵⁴

Murrumbidgee Horticulture Council Inc. (MHC) noted:

... the level of information requested should be readily available to operators and that consequently providing this information to their customers should not be a major cost burden.¹⁵⁵

In its submission, Macquarie River Food and Fibre (MRFF) noted that it:

... supports the objective of achieving pricing transparency via providing customers with price and tariff schedules ... [and] considered appropriate that such information would be provided direct to customers, rather than incurring expensive and unnecessary costs in publishing information in print or electronic media.¹⁵⁶

In responding to the draft advice and rules, three operators raised concerns that the one-month advance notice to customers of changes to fees and charges was too long. In particular, it was noted that the setting of charges for an upcoming irrigation season was typically left until close to the start of the season, and in some cases until a few weeks into the season, when indications of likely water allocations are available and government and bulk water charges are known.

In its submission to the draft advice, WMI noted:

WMI completes its financial budgets in May\June with the Board signing off in June. The fee schedule is provided to each customer via the mail with the first quarterly invoice of the irrigation season, which is generally sent in the third week of July. The timeframe for finalisation of the fees schedules in the rules should be 1 July.¹⁵⁷

At the public forum, Central Irrigation Trust (CIT) noted that it sets its charges by late August and requested that the rules allow for this. Murray Irrigation Limited (MIL)

¹⁵³ Submissions to the ACCC water charge rules position paper, November 2008, by MRFF, p. 3; NSW Irrigators' Council, p. 6; MHC, pp. 1 and 3; National Farmers' Federation, p. 4.

¹⁵⁴ WMI, submission to the ACCC water charge rules position paper, November 2008, p. 2.

¹⁵⁵ MHC, submission to the ACCC water charge rules position paper, November 2008, p. 1.

¹⁵⁶ MRFF, submission to the ACCC water charge rules position paper, November 2008, p. 3.

¹⁵⁷ WMI, submission to the ACCC water infrastructure charge rules draft advice, May 2009, p. 3.

also noted its preference that charges should be made available by 1 July of the relevant year rather than one month before changes take effect.

With reference to the costs of publishing, WMI also asserted:

It would cost WMI thousands of dollars to print its full A4 charges schedule in a local newspaper for no benefit.¹⁵⁸

Instead, WMI suggested a central online repository for operators' schedules of charges, such as the future Bureau of Meteorology database.

Murrumbidgee Irrigation (MI) noted that the Gazette is not widely read by customers and other stakeholders and submitted:

If publication in the local newspaper is deemed to be appropriate, why is that not sufficient for all operators?¹⁵⁹

Similarly, MRFF submitted:

MRFF believes that the requirement to publish a schedule of charges in the newspapers and/or the Gazette is unnecessarily onerous.

... Requirements ... to publish the schedule in print media, would only serve to add additional cost and burden to the Operator, and therefore irrigators.¹⁶⁰

At the public forum, MIL advised that electronic distribution of information to customers is now part of their business practices and submitted that the water infrastructure charge rules should not unwind progress towards adoption of new technology and cost-saving measures by businesses.

On the information content to be published under tier 1 rules, MI submitted:

... those member operators that are not subject to tier 2 rules could be expected to supplement the pricing information with a summary of expected revenue and costs applicable to each service charge.¹⁶¹

On the issue of the inclusion of contract charges in an operator's schedule of charges, SunWater submitted:

... the proposal to require the publication of all contract pricing information is unnecessary and contrary to the requirements of the legislations.

... individually negotiated charges and supply arrangements should not be required to be published, particularly in circumstances where an individual customer ... [has] entered into [a] "foundation customer contract" ...

¹⁵⁸ WMI, submission to the ACCC water infrastructure charge rules draft advice, May 2009, p. 2.

¹⁵⁹ MI, submission to the ACCC water infrastructure charge rules draft advice, June 2009, pp. 3-4.

¹⁶⁰ MRFF, submission to the ACCC water infrastructure charge rules draft advice, May 2009, p. 1.

¹⁶¹ op. cit., p. 7.

... The method proposed by the ACCC to allow such information not to be published provides insufficient protection for individual companies, particularly where initial agreements are struck with competing interests.¹⁶²

4.1.2 ACCC assessment

As discussed in the draft advice, achieving pricing transparency is a water charging objective of the Water Act.¹⁶³ Section 92(3)(j) of the Water Act provides that the rules may require the person determining regulated water charges to publish details of the charges and the process for determining the amount of the charges.

Providing customers with a schedule of fees and charges is intended to give them the information they need for their own costing and planning. Schedules of water infrastructure fees and charges should provide sufficient detail to enable customers to calculate water delivery costs and to make comparisons with other valleys, regions or market segments. The price information should be provided on a consistent basis so that it captures changes in fees and charges over time.

All operators are required to publish a schedule of regulated water charges¹⁶⁴ but, as discussed in chapter 3, the tiered approach is intended to ensure that the costs of regulatory compliance are justified by the benefits obtained from the regulation. In line with this approach, the publication requirement will reflect the different circumstances of operators.

The rules will require that operators provide a schedule of fees and charges for regulated water infrastructure charges to customers and to any person who requests it. This will satisfy the publishing requirement for operators of small networks servicing water access entitlements totalling less than 10 GL.¹⁶⁵ Operators above this threshold will also be required to publish their schedule of fees and charges in a manner that makes it generally available. The draft advice provided two options to meet this requirement: publication in a newspaper circulated in the region of network operation or publication in the Gazette at the time new charges come into effect.

The 10 GL entitlement threshold in the draft rules establishes that some operators in tier 1—as well as tier 2 and tier 3 operators—must publish their schedules more widely. It is expected that the tier 1 operators who will be required to publish more widely under the 10 GL threshold are:

- Jemalong Irrigation Limited

¹⁶² SunWater, submission to the ACCC water infrastructure charge rules draft advice, May 2009, p. 1.

¹⁶³ Schedule 2, clause 2(d) of the Water Act.

¹⁶⁴ Fees and charges made under a contract may be exempted from inclusion in the schedule of fees and charges for regulated water charges.

¹⁶⁵ A 10 GL threshold also applies under the water market rules that were registered on 22 June 2009 (see www.accc.gov.au/content/item.php?itemId=878181&nodeId=ffe5587f61ebb33f04cafb01a5bffa884&fn=Water%20Market%20Rules%202009%20.pdf) for the size at which operators are required to have details of procedures for transformation of irrigation rights readily available to persons holding irrigation rights against the operator.

- West Corugan Private Irrigation District
- Grampians Wimmera Mallee Water
- Narromine Irrigation Board of Management
- Trangie Nevertire Irrigation Scheme
- Western Murray Irrigation Limited
- Moira Private Irrigation District
- Renmark Irrigation Trust
- Tenandra Scheme
- Buddah Lake Irrigators
- Abercrombie Pumping Association
- Eagle Creek Pumping Syndicate
- Coliban Water
- SA Water
- Hay Private Irrigation District.

The draft advice and rules required that operators publish a schedule of their water infrastructure fees and charges within three months of the rules coming into effect and, subsequently, one month before changes to these fees and charges take effect.

Concerns of operators that provision to customers of a schedule of charges for a new irrigation season one month before they take effect posed difficulties for them have been noted by the ACCC.

In recent years of low water availability, allocations have been announced late in the season or incrementally through the year. Also, operators providing bulk water services will be required under the rules to provide their charges to downstream operators in a timely manner. Consequently, delay in advising customers of charges is unlikely to significantly improve relevant information available to operators.

It is not appropriate for customers to be incurring costs before those costs are known to them. Therefore, and in light of the marginal benefit derived from delaying the setting of prices, the ACCC considers that notice of changes to regulated charges should be provided before they take effect. However, the advance notice required is reduced from one month to two weeks in the draft rules accompanying this advice.

The ACCC considers that there is merit to the argument that electronic publication should be a permissible means of making relevant operators' schedules widely available. Therefore, the draft rules accompanying this advice allow operators a third option to meet the wider publication obligation: publication on a publicly accessible page of its internet site. This is a cheaper option for operators who maintain an internet site than publication in a newspaper and has the advantage that an operator's schedule of charges is continually available to anyone wanting that information.

The draft advice and rules did not prescribe the manner in which operators must provide their schedule to customers. The requirement is that all customers are to be

provided with the schedule, while the manner of that provision—including electronic options of a file attachment to, or internet page link in, an email—is a matter for the operator and its customers. Guidelines to be developed by the ACCC to assist operators to comply with the water infrastructure charge rules will detail these options and the measures operators should follow to ensure all customers receive their schedule in compliance with the rules.

The schedule of fees and charges that all operators are required to publish must provide:

- details of regulated charges:
 - for water infrastructure access—including services related to that access or provided through the operation of that infrastructure
 - for bulk water services
 - related to the taking of water from a water resource
- sufficient information to enable a customer to calculate their total bill based on an estimate of demand
- any rate differentials applying across regions or customer segments within the operator's network
- details of discounts, rebates or surcharges and the circumstances in which they apply.

In addition, irrigation infrastructure operators will be required to show separately in their schedule of charges components of charges that are for:

- bulk water charges imposed by another infrastructure operator
- storage of water in connection with services provided through the irrigation network
- connecting or disconnecting a customer
- the holding or management of water access entitlements held by the operator.

The ACCC notes the suggestion that operators not subject to tier 2 requirements also publish information on expected revenue and costs for each service charge but considers that the benefits of this further regulatory requirement are not likely to justify the additional burden on affected operators.

An operator's schedule of fees and charges must also include the details of any charges levied under contracts between an operator and a customer (or its customers), except where an exemption is granted by the ACCC.

The draft advice provided that the ACCC will only grant an exemption where it is satisfied that publication of the contract affects the operation of the businesses of the operator and its contracted customer(s) in a materially adverse way. The ACCC considers that this provision is adequate to ensure commercial disadvantage does not arise as a result of the publication requirement. In other circumstances the benefits of increased transparency in water infrastructure markets outweighs the commercial

sensitivity felt by parties to contracts. Therefore, the provisions of the draft advice and rules have not been changed.

To be granted an exemption, both the operator and its contracted customer(s) must be parties to the application for exemption. The application must contain an explanation of how and why the publication of the contract charges will adversely affect the operation of the businesses of the operator and its contracted customer(s).

For contracts in existence before the commencement of the rules, operators will have three months in which to obtain an exemption from the ACCC. Parties to new contracts must seek exemption before the contract is entered into. The ACCC will make its decision within 30 business days or within a period as extended under the rules; if this period lapses, the extension will be taken to have been given.

While publication of schedules of fees and charges under these requirements should not be onerous, the draft rules provide for a three-month phase-in period for compliance with all tier 1 rules.

The tier 1 publication requirements are in Parts 2 and 4 of the draft rules; rule 4 in Part 1 of the draft rules provides a list of what is required in the schedule of charges.

4.2 Non-discriminatory pricing

Price discrimination occurs when customers are charged different prices for the same product or service with the same characteristics and features and of the same quality or standard. Price differentials that reflect different costs of supply do not constitute price discrimination.

The non-discrimination rule will permit differential pricing within the irrigation sector where this aids efficiency or contributes to the objectives and principles of the Water Act. However, it will prohibit differentials based on unfair discrimination against member customers who have transformed all or part of an irrigation right or non-member customers by member owned operators.

The draft advice proposed that differences in water charges payable to an operator for access services in respect of an irrigation right and for access services provided otherwise should be those due only to differences in actual costs necessarily incurred.

The draft advice also recognised that member owned operators would be able to circumvent the non-discrimination rule by increasing charges to all customers and returning profits to member customers through distributions. The draft rules provided for the ACCC to undertake approvals or determinations in the case of operators that adopt this approach. When approving or determining regulated charges in such cases, the ACCC must be satisfied that the return on investment included in regulated charges does not exceed an amount commensurate with the commercial risk involved.

4.2.1 Views of interested parties

A number of submissions discussed the proposal in the position paper for the rules to prohibit certain limited price discrimination and raised questions about how the rule would operate in practice. Generally, submissions to the position paper did not object to the proposed prohibition on unfair price discrimination within the irrigation sector.

WMI supported the proposal:

In terms of the prohibition of unfair discriminatory pricing, WMI's concurs with different pricing based on different levels of service rather than the nature of the individual (members versus non-member).¹⁶⁶

However, MI submitted that:

If MI agrees with some or all of its customers to structure pricing on a model other than cost recovery this should be permissible.¹⁶⁷

Also, the National Farmers' Federation (NFF) noted:

... that irrigation infrastructure operators (IIOs) (private member owned businesses) do not currently pay dividends. In lieu, the operators are required to deliver water at least cost. ACCC notes that there is potential for discrimination between member and non-member irrigators. However, NFF recognises that there are reasonable grounds on which price differentiation does, and should continue, to occur. The issue is to ensure that there is transparency in the different pricing levels that is well understood by both groups of irrigators.¹⁶⁸

Stakeholders also commented on particular pricing practices and raised concerns or sought clarification about how the non-discrimination rules would apply in particular situations. SunWater raised the issue of price discrimination between irrigation and other downstream users in the context of current arrangements in Queensland:

SunWater's existing irrigation price paths are set to recover at least lower bound costs, whereas other customers – particularly local governments and industrial users – generally pay charges reflective of upper bound costs. In other circumstances some non-irrigation users pay charges in accordance with pre-existing contracts, and as a result may also involve different prices.

SunWater submits that the effective price differentiation for the irrigation sector is an outcome of the transitional nature of the reform process, and is consistent with the NWI and the pricing principles and objectives in the Act ...

SunWater's discounted prices for irrigation customers should therefore be seen in the context of transitioning over time. SunWater considers that under the ACCC regulatory framework, this transitioning of prices should be allowed to continue.¹⁶⁹

This position was endorsed by the Queensland Government in the following terms:

¹⁶⁶ WMI, submission to the ACCC water charge rules position paper, November 2008, p. 2.

¹⁶⁷ MI, submission to the ACCC water charge rules position paper, November 2008, p. 6.

¹⁶⁸ NFF, submission to the ACCC water charge rules position paper, November 2008, p. 6.

¹⁶⁹ SunWater, submission to the ACCC water charge rules position paper, November 2008, p. 2.

Queensland regards that ... legitimate situations of discriminatory pricing due to willingness to pay should also be permitted. In Queensland, the current pricing policies allow for differentials in price for the same product between different sectors. The rationale for this relates to capacity to pay between the rural and urban sectors.¹⁷⁰

CIT has residential and industrial customers that are not voting members and recommended that ‘the water charge rules apply only to irrigation customers’.¹⁷¹

Postage stamp pricing is common in the irrigation sector and some submissions provided support for this principle. The NFF submitted:

NFF supports the application of postage stamp pricing for use within IIOs [irrigation infrastructure operators] ... this principle is consistent with the use of average conveyance losses applying to the delivery of water across water sources and within IIOs [irrigation infrastructure operators]. After all, the application of the significant system losses to water for irrigators (in lieu of averages) from Hume Dam to the Riverland may mean that it is unprofitable to irrigate in these areas.¹⁷²

Also, the NSW Irrigators’ Council (NSWIC) noted:

... [it] remains opposed to pricing based on geographic location and reconfirms its commitment to socialised losses within infrastructure operators areas.¹⁷³

NSWIC is nevertheless of the view:

... that operators must have the capacity to charge a higher price to a non-member customer [as] a non-member customer has, by definition, removed their entitlement from the bulk entitlement and hence proffers less security to the IIO [irrigation infrastructure operator]. This higher risk profile must, pursuant to standard business practice, attract a higher price.¹⁷⁴

Mark Cameron also commented on member/non-member discrimination, noting in the context of member owned operators:

Dividends are a tool that could cause undue discrimination and are more likely to lead to monopoly rents ... if an operator wishes to pay dividends then it should become a tier 3 operator.¹⁷⁵

WMI raised the issue of casual use charges:

WMI remains unclear however if the casual user ... where the individual does not have delivery entitlement would be deemed to be discriminatory pricing.¹⁷⁶

¹⁷⁰ Queensland Government, submission to the ACCC water charge rules position paper, December 2008, p. 2.

¹⁷¹ CIT, submission to the ACCC water charge rules position paper, November 2008, p. 1.

¹⁷² NFF, loc. cit.

¹⁷³ NSWIC, submission to the ACCC water charge rules position paper, November 2008, p. 3.

¹⁷⁴ *ibid.*, p. 6.

¹⁷⁵ M Cameron, submission to the ACCC water charge rules position paper, November 2008, p. 1.

¹⁷⁶ WMI, loc. cit.

Two submissions to the draft advice and rules expressed ongoing concern with the non-discrimination rule and the associated proposal to require ACCC approvals or determinations for the regulated charges imposed by member owned operators above 10 GL that pay a dividend.

NSWIC reaffirmed:

... its position that member owned infrastructure operators must be able to charge pursuant to a different structure for non-member customers subsequent to the implementation of the Water Market Rules (Transformation).¹⁷⁷

NSWIC also stated:

The assertion of the ACCC that legitimate risk concerns are negated by Rule 10 of the Water Market Rules is disputed. The security provisions do not fully cover potential loss and most certainly do not cover the administrative and legal costs involved in pursuing such loss.¹⁷⁸

NSWIC was also strongly critical of the draft advice to include the provision for approvals or determinations triggered when a member owned operator makes a distribution to member customers.¹⁷⁹

MRFF supported the concerns raised by the NSWIC in relation to dividend triggered approvals or determinations.¹⁸⁰ NSWIC and MRFF also considered that the time allowed for consultation on this issue was insufficient.

MI supported the approval or determination of charges when member owned operators make distributions, however noted concern about the timeframe for such approvals or determinations:

...the need to seek an approval or determination when making financial distributions is supported, however, the minimum period of three months for providing such an approval may conflict with commercial imperatives. We suggest that this rule be accelerated to better match the commercial reality of privately owned operators.¹⁸¹

4.2.2 ACCC assessment

The intent of the non-discrimination rule is to promote the objectives of the Water Act and, in particular, to ensure that price signals received by irrigators and operators are consistent with the economically efficient use of water resources and infrastructure.

The focus of the rule is on discriminatory pricing that may arise where there are price differentials between charges to member and non-member customers for infrastructure

¹⁷⁷ NSWIC, submission to the ACCC water charge rules draft advice, May 2009, p. 6.

¹⁷⁸ *ibid.*

¹⁷⁹ *ibid.*

¹⁸⁰ MRFF, submission to the ACCC water charge rules draft advice, May 2009, p. 2.

¹⁸¹ MI, submission to the ACCC water infrastructure charge rules draft advice, June 2009, p. 6.

access and services related to access. Price differentials that exceed those due to differences in the cost of supply may create a disincentive to transform irrigation rights¹⁸² and, therefore, may undermine the economic efficiency objectives of the Water Act. As the changes underway in the MDB progress, the opportunity and incentives for such behaviours are likely to increase.

Operators should not be inhibited from charging non-uniform prices that give effect to the user pays and cost-reflective objectives and principles of the Water Act. It is important, however, that pricing is transparent and customers are aware of the factors behind price differentials, such as regional differences in the costs of supply.

In some cases, price discrimination may improve economic efficiency compared to uniform pricing. For example, a situation where price discrimination increases overall welfare is peak-load pricing implemented as part of a supplier's decision about the level of capacity to invest in and the allocation of sunk costs between peak and off-peak customers.

In other cases, however, discrimination may result in distortions and inefficient outcomes. Price discrimination that deters the trade of water from a lower to a higher value in use undermines the efficient operation of the water market and efficient investment decisions, both in the network infrastructure by operators and in on-farm investment by irrigators. Discrimination in the fees and charges applied to non-member customers compared with member customers is identified as the most likely source of such inefficiencies.

The rule is intended to ensure that any price differentials applied by operators between member and non-member customers is in line with differences in the costs incurred in supplying those customers or groups of customers. To this end, the non-discrimination rule will require that price differences in charges applying to members and non-members must only be those due to differences in actual costs necessarily incurred.

Application of the non-discrimination rule to the particular costs or situations raised by interested parties involves the following considerations:

- **Casual use charges**, which may apply in the case of a customer who holds a delivery right (either implicit or explicit) and buys additional water for which delivery is required or for a customer who holds no delivery right but requires delivery of water. Casual use charges can comprise the variable charge that applies to water delivered subject to a delivery right plus a contribution to fixed costs. The contribution to fixed costs should reflect a reasonable quantum.
- **Credit risk** has been raised as a cost that may be reflected in prices. While pricing for risk is a legitimate business practice, the cost cannot be recovered through a differential charge to non-members unless it is an actual cost necessarily incurred. If the risk has been mitigated through the security provisions permitted under rule 10 of the water market rules, there is no remaining risk to be costed into

¹⁸² Transformation is the process whereby an irrigator's irrigation right in relation to a group water entitlement held by an operator is converted into a separately held water entitlement.

regulated water charges as the value of security that may be taken is the applicable termination fee.

Concerns reiterated by NSWIC in its submission to the draft advice that operators should be permitted to price for credit risk were not supported by any evidence as to how credit risk that is not mitigated through the Water Market Rules 2009 would be quantified or priced by operators. Any remaining risk would be negligible and does not warrant a change in the policy or the rules to prohibit operators from discriminating in their charges against customers who have transformed their irrigation rights. In any event, if higher costs of debt recovery are incurred, operators may be able to make an appropriate adjustment to their charges—in line with the different average costs incurred for different customer groups—within the rules.

Moreover, as a practical issue, the ACCC notes that some operators have expressed the view that they do not have the resources to assess financial risk.¹⁸³

- **Pricing for a return on equity through member rebates or discounts** may also be considered by operators. A move towards upper bound pricing (that is, including a return on equity in fees and charges) is a specific water charging principle in the Water Act.¹⁸⁴ However, as for any differential reflecting supply costs, the operator must be able to justify the quantum of the discount or rebate as reflecting the cost of capital. Factors relevant in assessing that cost are the valuation of member equity and a return on that equity commensurate with the commercial risk involved.

MI submitted that it should be free to enter into individual pricing arrangements with customers (see section 4.2.1). The proposed rules will not prohibit operators from entering into contracts with a customer or customers. It would be an unintended consequence if the non-discrimination rule were to inhibit operators and their customers from entering into contracts designed to provide the necessary assurances for either party to undertake an investment or for uneconomic parts of a network to be decommissioned. However, the fees and charges in these contracts will still be subject to both the non-discriminatory pricing and publication rules, unless a publication exemption is granted. This is to ensure that the non-discrimination rules cannot be circumvented through the use of contracts with member or non-member customers.

The ACCC will develop guidelines to assist operators to comply with the non-discrimination rules when determining their regulated water charges.

After the release of the position paper, the ACCC identified the possibility that member owned operators may circumvent the non-discrimination rule by raising prices to all

¹⁸³ MIL, submission to the ACCC water market rules position paper, p. 16; WMI, submission to the ACCC water market rules position paper, p. 4. These views were also expressed in response to the water market rules issues paper—see Sunraysia Citrus Growers Inc., submission to the ACCC water market rules issues paper, p. 3; Mourquong Co-operative Rural Society Limited, submission to the ACCC water market rules issues paper, p. 3; WMI, submission to the ACCC water market rules issues paper, p. 26.

¹⁸⁴ Schedule 2, clause 3(4) of the Water Act.

customers and making profit distributions to members.¹⁸⁵ Mark Cameron noted that this was a means by which operators could discriminate against non-members.¹⁸⁶

Payment of distributions to investors is not, of itself, a concern. Indeed, the water charging principles of the Water Act include that water charges should move towards upper bound pricing—that is, a level that provides for full cost recovery, including the cost of capital, but avoids monopoly rents—where practicable.¹⁸⁷ However, a move to a for-profit business model creates the opportunity for operators to set access charges at levels greater than those consistent with full cost recovery and for monopoly rents to be returned to members in the distribution of profits. Moreover, such an approach would effectively circumvent the non-discrimination rule, diminishing the ability of the water infrastructure charge rules to fulfil the water charging objectives and principles under the Water Act, including the efficient allocation of water resources to their highest valued end use.

Under the provisions in the draft rules, a member owned operator servicing more than 10 GL of entitlement¹⁸⁸ that chooses to make distributions to members will be required to have its regulated water charges approved or determined by the ACCC.

If such an operator declares or makes a distribution to members in the 12 months before the rules come into effect, the operator will be required to have its charges approved or determined by the ACCC within the first three months of the rules being registered. After the rules commence, a relevant operator who declares or pays a distribution will be required to have its charges approved or determined by the ACCC.

After an operator has declared or paid a distribution once, the requirement to have changes to its fees and charges approved or determined will remain in force until the operator has ceased to be a member owned operator or has ceased to make a distribution to members for a period of five years.

When making an approval or determination in these circumstances, the ACCC will be required to follow a more limited process, and to consider a more limited set of considerations, than in the case of tier 3 operators. Specifically, the ACCC:

- must be satisfied that the return on investment is commensurate with the commercial risk involved
- may have regard to whether the charges contribute to the Basin charging objectives and principles under the Water Act.

The ACCC will be required to make a decision within three months of receiving an application. However, it may request further information from the operator and may

¹⁸⁵ MI developed a proposal to amend its constitution to allow payment of dividends, which was subsequently put to its members in May 2009.

¹⁸⁶ M Cameron, loc. cit.

¹⁸⁷ Schedule 2, clauses 3(5) and (6) of the Water Act.

¹⁸⁸ The volume of 10 GL includes the total volume of water that the operator and its customers are entitled to under water access entitlements.

extend the period in which it is required to make its decision. To extend the period, the ACCC will be required to notify the operator of the extension and the reasons for it.

The ACCC notes the submission from MI that the time taken for an approval or determination in these circumstances should be reduced to four weeks. However, in order to give due consideration to all the matters relevant to the approval or determination of regulated charges, including the views of stakeholders, the ACCC considers a minimum period of three months will be required.

Information that the operator will be required to provide in support of an application for approval or determination by the ACCC¹⁸⁹ includes:

- the regulated water charges for which approval is sought
- information on the cost components to be recovered through regulated water charges:
 - total operating costs
 - depreciation of capital assets
 - taxation
 - return on investment
- information on the composition and valuation of the operator's asset base
- the method and assumptions used to calculate the return on assets to be distributed.

The ACCC will develop guidelines and templates, as necessary, to assist operators in complying with these requirements.

Rules in relation to the non-discrimination requirements are in Parts 3 and 7 (and Schedule 2) of the draft rules.

4.3 Implementation

In the draft advice and rules, the ACCC recommended a three-month transitional period for compliance with the tier 1 publication and non-discrimination in pricing rules.

4.3.1 Views of interested parties

Generally, submissions to the position paper expressed the view that operators already comply with tier 1 rules. However, MRFF also noted:

There are Infrastructure Operators in the Macquarie that at the present time do not comply with the [tier 1] rules ... Therefore MRFF believes it is appropriate for ACCC to allow a reasonable transition period (6 to 12 months) for Schemes to adopt the changes necessary to comply with the Tier 1 rules.¹⁹⁰

¹⁸⁹ As set out in Schedule 2 of the draft rules.

¹⁹⁰ MRFF, submission to the ACCC water charge rules position paper, November 2008, p. 3.

Also, NSWIC noted the large number of small operators in New South Wales and disputed:

... that tier 1 operators “generally would already comply” on the basis that generalisations cannot be made about an indistinct population. At present, the ACCC, the Commonwealth and the NSW Government are unable to even determine how many tier 1 operators exist.¹⁹¹

In its submission to the draft rules and advice, MRFF acknowledged the transitional provisions in the draft rules but noted that it:

... is not convinced that the ACCC fully appreciates the numerous other changes required under new Water Market, Charge (Termination Fees) and Trading Rules. It is therefore requested that our initial suggestion of a 6-12 month transition period be reconsidered, particularly if the additional proposals for Operators with greater than 10GL were to advance.

4.3.2 ACCC assessment

The ACCC anticipates that operators generally would already comply with tier 1 rules and, for those who do not, the time required for, and the administrative burden of, compliance would not be significant.

The transitional period of three months from the registration of the rules provided should be sufficient to allow for any administrative tasks and approvals or determinations that will be required for operators to be compliant with the tier 1 rules. Guidelines will be prepared by the ACCC to assist operators to comply with their obligations under tier 1 rules within the transitional period.

4.4 Monitoring and reporting requirements

Under s. 94 of the Water Act, the ACCC is required to monitor and report to the minister on regulated water charges and compliance with the water charge rules.

Monitoring, required under s. 94 of the Water Act, will rely on evidence of non-compliance obtained through the enforcement functions of the ACCC.

The schedules of regulated fees and charges that operators are required to publish will be a key input to monitoring water charges. Initially, only comparisons of charges across the Basin will be possible, but eventually it will be possible to build a picture of the movement in charges over time.

Monitoring the tier 1 rules—requiring publication of a schedule of regulated water infrastructure charges and non-discrimination in pricing—will rely on evidence of non-compliance obtained through the ACCC’s enforcement functions (chapter 7).

¹⁹¹ NSWIC, submission to the ACCC water charge rules position paper, November 2008, p. 6.

5 Network service plans

This chapter details the tier 2 provisions that will apply to the larger of the member owned operators and medium-size non-member owned operators of water infrastructure.

Application of the criteria¹⁹² for coverage under tier 2 rules outlined in chapter 3 means that, at the time of release of this advice on the water infrastructure charge rules, the following operators will be subject to the tier 2 rules:

- Murray Irrigation Limited (MIL)
- Murrumbidgee Irrigation Limited (MI)
- Coleambally Irrigation Cooperative Limited
- SunWater
- Central Irrigation Trust (CIT).

The draft advice and rules proposed that tier 2 operators must provide certain information to customers and to follow procedures when setting regulated water infrastructure charges. These requirements are in addition to tier 1 publication and non-discrimination requirements.

The tier 2 draft advice and rules required operators to:

- develop and consult on a network consultation paper (NCP) that details options for the operator's network over a five-year period
- develop and provide to customers a network service plan (NSP), based on the outcomes of the NCP consultation process, which details major capital works and associated expenditure over a five-year period, and have that NSP reviewed by an external engineering consultant
- publish a schedule of fees and charges before they come into effect
- develop and provide to customers a copy of an information statement¹⁹³ that outlines any changes in charges and the cost drivers giving rise to those changes, each time charges are to change.

Operators will be able to change charges (even where changes do not completely align with those proposed in the NSP) without needing to revise the NSP, provided the information statement accompanying the new schedule of charges explains the reasons

¹⁹² The thresholds for an operator to be required to comply with tier 2 rules are:

- member owned operators with an entitlement (or servicing customers with a combined entitlement) within the Murray–Darling Basin (MDB) of over 125 GL
- predominantly non-member owned operators with an entitlement (or servicing customers with a combined entitlement) within the MDB of over 125 GL but below 250 GL.

¹⁹³ The information statement was called an explanatory statement in the position paper, but terminology has been changed to avoid confusion with the explanatory statement required for regulation and legislation.

for those changes, including reasons for differences between the published fees and charges and those proposed in the NSP.

The draft advice and rules provided a 12-month transitional period for compliance with tier 2 rules. This implied a probable compliance date in the early part of the December quarter, 2010.

The draft tier 2 rules have been developed having regard to current governance and charging arrangements and are designed to contribute to the water charging objectives and principles of the *Water Act 2007* (Cwlth) (the Water Act).

5.1 Views of interested parties

Most submissions received in response to the position paper endorsed the tiered regulatory proposal and application of tier 2 rules to the larger member owned cooperatives and medium-size non-member owned operators (section 3.1.1).

Comments on the proposed tier 2 rules provided in submissions generally addressed the specifics of the proposals—how they relate to existing arrangements and their applicability to particular entities. However, some submissions commented on the wider implications of the proposed tier 2 rules. For example, the Queensland Government:

... agrees that it is appropriate that SunWater is a tier 2 Operator ... as this will promote a better understanding of water pricing for water users. This will lead to water users making more informed decisions relating to efficient water use, investment and trading.¹⁹⁴

Submissions noted the importance of the consultative process in setting water charges. In supporting the tier 2 proposals, the Murrumbidgee Horticulture Council Inc. (MHC) emphasised the importance of consultation and information-sharing in the price determination process and submitted:

In particular:

- That consultation be defined in the tier 2 rules as a multistage, two way process so that operators advising customers of changes is not considered “consultation”.
- That the tariff schedule and explanatory statement also include a comparison with water charges relating to transformed entitlements.
- That the detail of rebates or discounts (including water or other dividends) given by the company be disclosed in advance (along with the circumstance under which such rebates or discounts will apply or be forfeited).¹⁹⁵

¹⁹⁴ Queensland Government, submission to the ACCC water charge rules position paper, December 2008, p. 1.

¹⁹⁵ MHC, submission to the ACCC water charge rules position paper, November 2008, p. 1.

The Queensland Farmers' Federation (QFF) also commented on the need for:

Effective engagement of scheme customers to work directly with SunWater in price setting.¹⁹⁶

CIT provided details of its price setting procedures that it considers would be compliant with the tier 2 proposals contained in the position paper. In particular, CIT noted that it:

...undertakes extensive consultation with its grower owners prior to establishing its water charges.¹⁹⁷

Similarly, MI noted that it:

... liaise[s] closely with customers regarding any changes to servicing in response to seasonal conditions and industry needs, such as season duration and areas of supply restriction due to drought.¹⁹⁸

However, MI strongly rejected the application of tier 2 rules to member owned irrigation corporations, stating in relation to an NSP and expenditure program that it:

... does not currently publish a formal network servicing plan and nor have our customers requested such a plan ... a formal annual plan is a matter for each business and presumably would be implemented if broadly supported by customers ... an expenditure program for the finalised network service plan is a matter for MI Directors not customers – MI is a public company not a government authority.¹⁹⁹

Further, MI made similar points regarding the details of the proposed requirement to publish an explanatory statement to the schedule of fees and charges:

... [with respect to detailing] changes, including to service standards and regulatory and other obligations that will occur over the ... with public corporations it is a function of our board to review such material, not customers

... [with respect to detailing] major operating and capital expenditure cost drivers affecting current prices ... with public corporations it is a function of our board to review such material, not customers ...

... [with respect to detailing] the aggregate change in operating and capital expenditure between the current and previous year and the impact of that change on the revenue required by the operator; details of how that impact is calculated ... we establish an annual budget which is approved by Directors and incorporates water and non-water income. Much of this is commercial in-confidence and will not be published ahead of the annual activity. We will continue to report annually in arrears to shareholders ...

... [with respect to] details of all grants, subsidies and contributions paid to the business ... with public corporations it is a function of our board to review such material, not customers. We establish an annual budget which is approved by Directors and incorporates water and non-water income. Much of this is commercial in-confidence

¹⁹⁶ QFF, submission to the ACCC water charge rules position paper, December 2008, pp. 2–3.

¹⁹⁷ CIT, submission to the ACCC water charge rules position paper, November 2008, p. 1.

¹⁹⁸ MI, submission to the ACCC water charge rules position paper, November 2008, p. 7.

¹⁹⁹ *ibid.*

and will not be published ahead of the annual activity. We will continue to report annually in arrears to shareholders ...

... [with respect to providing] a breakdown of the change in an average or representative irrigator's bill into components based on the major drivers of the price changes ... this is a matter for Directors.²⁰⁰

Submissions also raised specific issues and concerns regarding the operation of the procedural requirements. While SunWater endorsed the need for a network service plan, it noted:

... an unnecessary and costly regulatory burden would arise if operators were required to prepare separate plans under two separate regulatory frameworks. ... SunWater submits that the water charge rules continue to require a network management plan to be produced and published, but allows for other plans prepared for compliance purposes to be considered as satisfying this requirement.²⁰¹

CIT also noted the scope for existing practices to meet the tier 2 requirements and further:

... request[ed] that our current process is ratified for continued use and satisfies our commitment to the tier two pricing principles.²⁰²

The QFF recommended a number of issues to be included in price setting processes which included (but were not restricted to):

- Analysis of service standards and regulation to allow for development and implementation of changes to reduce costs ...
- Allocation of costs to schemes addressing such issues as allocation of direct and indirect costs, proportioning of costs to scheme segments, allocating costs to customer sectors, excluding non related costs from the allocation process and allocation of channel and pipeline distribution losses²⁰³

Two submissions raised the issue of independent review or audit in response to the position paper. The New South Wales Independent Pricing and Regulatory Tribunal (IPART):

... considers that there may ... be some potential for member owned operators to make insufficient provision in prices to renew or replace their infrastructure – particularly if the operator expects governments will invest in these systems (eg, via grants). Therefore, IPART considers that some outside scrutiny of investment decisions may be required to guard against under investment. For example, this could be in the form of independent review or audit of network service plans and expenditure programs of Tier 2 operators. To ensure that regulation remains sufficiently proportionate and targeted,

²⁰⁰ *ibid.*, pp. 7–8.

²⁰¹ SunWater, submission to the ACCC water charge rules position paper, November 2008, p. 3.

²⁰² CIT, *loc. cit.*

²⁰³ QFF, *loc. cit.*

such independent review or audit could occur once every few years (eg, once every four or five years, rather than annually) and could be applied on a risk based approach ...²⁰⁴

While the QFF recommended:

... [i]ndependent cost and efficiency reviews based on a nationally consistent framework ...²⁰⁵

Further, in its response to the draft advice and rules, MI submitted:

The requirement for an independent engineer to review tier 2 documentation should be omitted from the rules.²⁰⁶

On the capacity of operators subject to tier 2 rules to meet the requirements, the NFF considered that:

... many operators that fall under tier 2 may need little further work to comply with this tier.²⁰⁷

The QFF addressed the need for transitional arrangements in Queensland:

SunWater should prepare annual reports addressing the issues listed for the Explanatory Statements for each scheme to provide an effective monitoring of the implementation of the price paths to June 2011.²⁰⁸

Issues related to the tier 2 draft rules were raised in four submissions in response to the draft advice and, also, at the public forum.

In relation to NSPs, the NSW Irrigators' Council (NSWIC) noted in its submission to the draft advice and rules that the sector has been undergoing significant change and that:

It is completely unrealistic to expect an operator to commit to a fixed plan when the environment in which they must operate is so very far from fixed ...

... [and] where infrastructure operators can have no clear view of how much water will be inside their system nor, for that matter, where inside its system that water will need to be delivered, it is nonsensical to suggest that an operator can provide a fixed 5 year infrastructure plan.²⁰⁹

SunWater stated that:

²⁰⁴ IPART, submission to the ACCC water charge rules position paper, November 2008, p. 3.

²⁰⁵ QFF, op. cit., p. 2.

²⁰⁶ MI, submission to the ACCC water infrastructure charge rules draft advice, June 2009, p. 6.

²⁰⁷ NFF, submission to the ACCC water charge rules position paper, November 2008, p. 4.

²⁰⁸ QFF, op. cit., pp. 2–3.

²⁰⁹ NSWIC, submission to the ACCC water infrastructure charge rules draft advice, May 2009, p. 7.

The requirements to prepare Network Consultation Papers and Network Service Plans for both bulk water and distribution networks is considered onerous ...it would be more efficient to require the development of a single Network Service Plan.²¹⁰

MI also commented on the network consultation paper:

The requirement for an options paper (or NCP) should be omitted from the rules, and replaced with a requirement to formulate and distribute a draft NSP to customers for consultation and feedback before finalisation – with specific provision for customers to suggest alternatives for consideration before finalization of the NSP.²¹¹

SunWater also raised the fact that it has regulated price paths in place until 30 June 2011 and submitted that:

The costs of compliance with Tier 2 rules will be substantial if Network Consultation Papers and Network Service Plans are required to be negotiated with customers across SunWater's six MDB schemes, but with the price path in place, the plans would have no value and cannot be implemented. SunWater submits that the requirement for compliance should be postponed until the expiration of the price path.²¹²

In its submission to the draft advice and rules, QFF provided support for SunWater's submission, noting that added costs and duplication of assessments would occur if SunWater's compliance with the tier 2 rules was not delayed until July 2011. QFF also noted that procedures for setting charges should recognise the significant difference in the size of SunWater MDB schemes.²¹³

CIT and MIL raised concerns at the public forum about the cost impost of an independent engineer's review of NSPs and questioned the need for them given in-house engineering expertise.²¹⁴

5.2 ACCC assessment

In competitive markets, customers reveal their preference through their choice of goods and services and suppliers. As noted in chapter 3, the governance arrangements of cooperatives operating natural monopoly infrastructure—under member-customer ownership and a non-profit business model—are presumed to provide the incentives necessary to ensure efficiency in the level of prices and of service standards and to mitigate the exercise of market power. For incorporated entities, the accountability of the board and management to member customers is also supported by the provisions of the *Corporations Act 2001* or state laws such as the *Cooperatives Act 1992* (NSW).

²¹⁰ SunWater, submission to the ACCC water infrastructure charge rules draft advice, May 2009, p. 1.

²¹¹ MI, submission to the ACCC water infrastructure charge rules draft advice, June 2009, p. 9.

²¹² *ibid.*, p. 2.

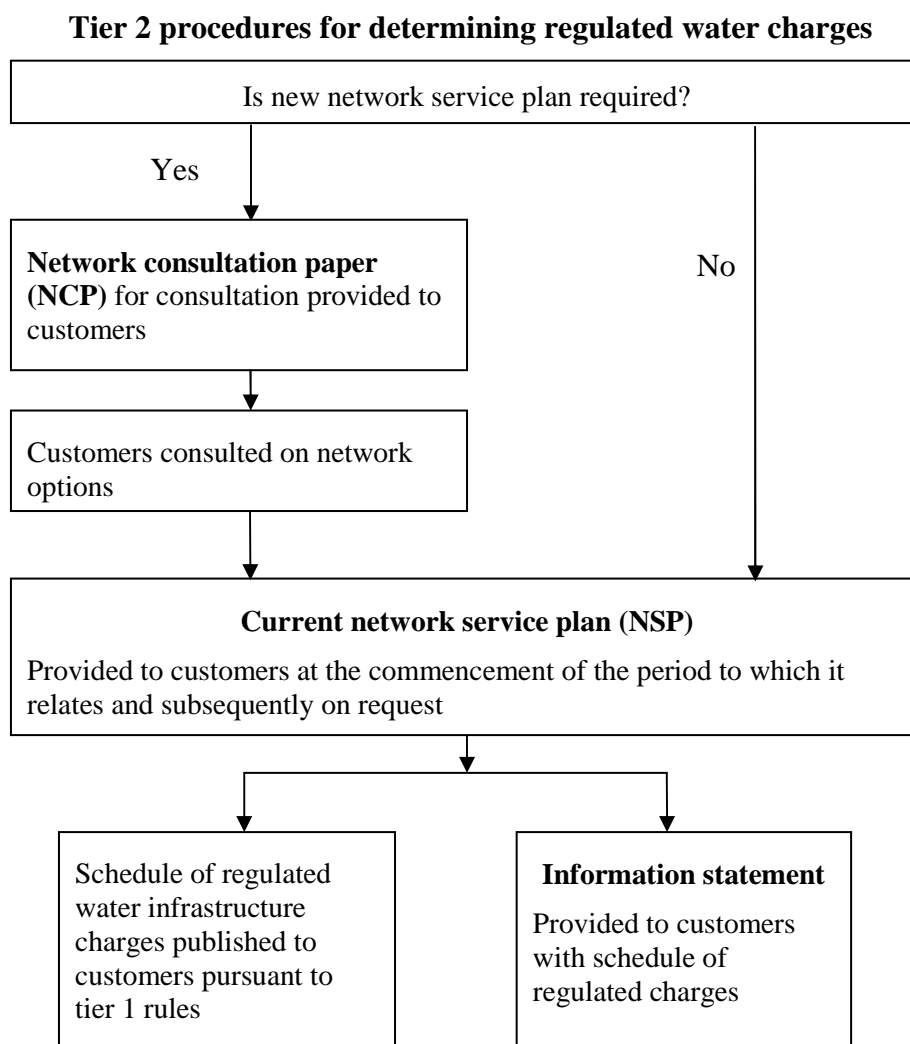
²¹³ QFF, submission to the ACCC water infrastructure charge rules draft advice, May 2009, p. 1.

²¹⁴ See summary of the public forum discussion on the ACCC website at <http://www.accc.gov.au/content/item.phtml?itemId=874119&nodeId=5be4acfe01bc1f4e1f2c722857c6b2f9&fn=Summary%20of%20public%20forum%20discussion.pdf>.

The tier 2 draft rules for water infrastructure charges establish procedures and processes to provide necessary assurances in this regard. The draft rules build on existing governance arrangements and the structures operators already have in place. There is likely to be some differences between operators in the extent to which existing arrangements meet the requirements of the tier 2 draft rules.

The rules provide an integrated framework of customer consultation and information provision that ensure the views and preferences of customers, both member and non-member, are known to the operator and that customers are fully informed of major decisions made concerning the management and maintenance of the network. This information is a necessary input to business decision-making by irrigator customers.

The procedures required under the draft rules are illustrated in the flow chart below with the key outputs in bold. These procedural requirements are discussed in the following subsections.



5.2.1 Network service plan

The tier 2 rules require that an operator must prepare an NSP at least every five years as part of the process undertaken to determine regulated water infrastructure charges. The NSP must be developed in consultation with customers. In particular, it must follow the development of, and consultation on, a network consultation paper and must consider any submissions or comments received to or about the NCP (see below).

The NSP should clearly outline the outcomes the operator expects to achieve for the network, the proposed service delivery standards and the maintenance and investment program necessary to meet those outcomes over the period of the NSP. The NSP should include details of longer term outcomes, particularly those the operator expects will have a material impact on service standards and prices. As operators commonly reset prices annually, the NSP should extend beyond the horizon of the charging period²¹⁵ and must:

- be updated every five years, or more frequently at the operator's discretion
- be finalised only after customer consultation on options for the network (section 5.2.3)
- contain the following information:
 - details of the expected network and service outcomes over the five-year period (including any regulatory obligations)
 - details of the proposed expenditure program, including capital and operating expenditure for maintenance and investment over the period
 - details of the required revenue for each year of the five-year period for which the NSP has been developed
 - estimates of the regulated charges during each year of the NSP
- be reviewed by an external engineering consultant
- be provided to customers when it is completed together with:
 - a summary of the consultation undertaken
 - a summary of submissions and comments received from customers
 - an explanation of decisions made by the operator in completing the plan.

The tier 2 rules require that, if operators determine regulated water charges that vary from the estimates contained in the NSP, any changes to charges from those proposed in the NSP must be explained in the information statement accompanying the schedule of regulated charges.

As noted in some submissions, operators typically have forward planning arrangements in place. These systems should enable operators to readily prepare the NSP provided for under these draft rules.

²¹⁵ The term 'charging period' refers to the minimum period for which the charges are to apply and is typically shorter than the planning horizon of the network service plan.

The intent of the finalised NSP is to provide information to customers and therefore the material contained in it should be provided in sufficient detail and presented in a manner fit for this purpose. In particular it should clearly specify the service standards and other deliverables planned for the network and identify the change in the revenue required to meet these service standards and regulatory obligations.

While documents prepared for other purposes—such as for management or to meet other regulatory requirements—may be useful starting points for the preparation of the NSP, it is unlikely that such documents would meet the requirements of the draft rules without amendment. With reference to SunWater’s concerns noted above, there is no requirement under the rules for a vertically integrated operator to prepare separate NSPs for its different areas of operation.

The ACCC does not agree with observations made in the submission to the draft advice by NSWIC that changes in their operating environment—including the provision of funding for infrastructure planning and modernisation—make it ‘completely unrealistic to expect an operator to commit to a fixed plan’.²¹⁶ The ACCC understands that operators that will be subject to the tier 2 rules undertake forward asset management planning as a necessary input to establishing their capital programs and renewals annuities. Assessment of, and strategic response to, risks in a changing environment is part of such planning and sound business practice.

Moreover, the rules allow operators to revisit their NSP if required and to vary charges from those anticipated in their NSP, subject to providing an explanation in the information statement.

Nevertheless, changes occurring in the sector—particularly modernisation funding—is a factor in the consideration of transitional arrangements discussed in section 5.3.

Water infrastructure operators required to comply with tier 2 rules are responsible for significant assets, and independent review of asset management plans and expenditure programs is an appropriate tool to ensure prudent and efficient management of those assets. As noted, submissions to the position paper were made concerning the importance of such reviews.

The ACCC concurs that an independent engineer’s review of network management decisions is desirable because it will promote the efficient use of water and water infrastructure. An external review of an operator’s finalised NSP will provide independent assessment of the prudence and efficiency of the plans for the network. This will provide assurance that the regulated water charges set by an operator to meet the costs of its network reflect prudent and efficient costs.

However, the ACCC notes stakeholders’ concerns about the cost of compliance with the requirement for an independent engineer’s review of an operator’s NSP. The ACCC has decided to respond to these concerns and to amend the rules to require a tier 2 operator to provide its NSP to the ACCC, and provide for the ACCC to commission an engineer’s review of the NSP.

²¹⁶ NSWIC, loc.cit.

Under the draft rules accompanying this advice, tier 2 operators will be required to provide their NSP to the ACCC no later than the date when it is provided to customers. However, the option will be available to operators to provide their NSP to the ACCC earlier, and for the engineer's review to be undertaken at a time that enables the operator to make changes in light of comments made in the review. In these circumstances the ACCC would pursue best endeavours to ensure that the engineer's review is available to the operator within four months of the ACCC being provided with the NSP. These changes have implications for the transitional arrangements for compliance with tier 2 rules, which are discussed in section 5.3.

This approach enables the benefits of a review, in terms of informing customers and encouraging prudent and efficient expenditure, to be achieved without operators being required to meet the costs. Operators will be required to publish the review on their internet site once it has been provided to them.

5.2.2 Consultation paper for network service plan

The process for developing a new NSP commences with the preparation of an NCP that assesses the needs of the network and develops options to meet those needs over a five-year planning horizon. The NCP is provided to customers and forms the basis for the consultation process through which customers provide feedback on the strategic direction and major investment decisions taken for the network.

The NCP must include the following information:

- identified risks and regulatory obligations for the period
- capital and operating expenditure program options to meet network needs, where necessary
- external consultant reports, where these have been obtained, that identify network needs and options to meet those needs
- indicative costing of the option(s) and implications for fees and charges.

The NCP should be fit for its intended purpose, providing sufficient detail for an informed assessment of the options proposed by the operator and presented in a manner accessible to the intended customer audience. The draft rules specify requirements for customer consultation procedures, including the requirement for operators to develop an NCP and to provide this to customers for comment. The ACCC will develop guidelines to assist operators to meet these requirements.

5.2.3 Customer consultation

As noted above, the potential for the large member owned operators to exercise market power is mitigated in part by board accountability to member customers under governance provisions of the Corporations Act or other state legislative schemes such as the Cooperatives Act (NSW). However, a board's accountability is limited to its member customers and does not extend to its non-member customers. Moreover, for members, voting out the board is a blunt instrument compared with more iterative and dynamic response mechanisms. Also, the transaction and other costs necessary for

member customers to relocate their agricultural investment away from an operator's irrigation district are so high as to make this competitive threat insignificant.

For the governance arrangements in place for member owned operators to be effective, the customer consultation process must be robust and must provide opportunity for customer views to be heard on important decisions regarding the network. It also must be able to accommodate a possible lessening in the nexus between members and customers in the future.

Customer consultation procedures and arrangements should be appropriate to the circumstances and should:

- be open and transparent
- have mechanisms—such as public forums or representative committees—to ensure all customers have the opportunity to provide views on the NCP
- provide sufficient time for customers to consider the NCP and provide feedback.

Company boards and management remain responsible for the decisions they take, including how they utilise the information received about customers' expectations and preferences during the consultation process. As detailed in the discussion of the NSP above, operators are required to include an account of the consultation undertaken with their NSP. This account will detail the consultation process, the input received from customers and the reasons for the decisions taken in light of that input.

Submissions to the position paper indicate that the operators that will be subject to the tier 2 rules already consult with their members. The draft rules require that consultation be extended to include non-member customers if that does not already occur.

5.2.4 Publishing an information statement

The information statement is intended to provide customers with an explanation of the drivers contributing to the changes to regulated water charges included in a new schedule of fees and charges. Its purpose is to provide a link between the NSP and the schedule of regulated water infrastructure charges.

The purpose of the information statement is to inform customers of:

- actual revenue received from regulated charges for each completed year of the current NSP
- anticipated revenue from regulated charges in the current and future years of the NSP
- details of, and an explanation of the reasons for, any adjustments made to regulated charges from those proposed for that year in the NSP
- an explanation of any differences in charges applying to member and non-member customers.

The draft rules for the information statement require that the information outlined above is to be provided to customers at the same time as the schedule of regulated charges is published under tier 1 provisions, subject to the transitional provision that

applies to all tier 2 provisions (section 5.3). There will not be a requirement that the information statement be published as widely as the schedule itself in the case of larger operators.²¹⁷ Timing of publication will be as determined by the operator, subject to tier 1 requirements and tier 2 procedures.

Information an operator needs to prepare the information statement should be readily available from existing business processes and procedures. The ACCC intends to develop guidelines, including pro-forma, to assist operators to prepare the explanation of fees and charges.

5.2.5 New schedule of regulated water charges

The price setting procedure is completed with the preparation of a schedule of regulated water infrastructure charges that, on the basis of forecast demand, will recover the revenue the operator requires to meet the expenditures provided for in the NSP.

Under the tier 1 rules outlined in chapter 4, the schedule of fees and charges must provide full details of the structure of fees and charges, including how they vary between regions or across different customer segments and services. Discounts, rebates and surcharges that may apply must be included in the published schedule.

Publication requirements for the schedule of regulated water charges are provided under tier 1 rules discussed in chapter 4.

5.3 Implementation

5.3.1 Application, implementation and transitional arrangements

As discussed in chapter 3, tier 2 water infrastructure charge rules will apply to:

- member owned operators where the total volume of entitlement²¹⁸ to which the operator and its customers are entitled within the MDB exceeds 125 GL
- non-member owned operators where the total volume of entitlement²¹⁹ to which the operator and its customers are entitled within the MDB exceeds 125 GL but is less than 250 GL.

It is expected that the operators required to comply with tier 2 rules, listed at the start of the chapter, already undertake most, if not all, the processes required under the tier 2 rules. Nevertheless, it is likely that some operators will require time to ensure capacity to prepare the NSP and information statements in compliance with the rules.

²¹⁷ That is, it will not be necessary to publish it widely on the operator's internet site or in a newspaper or the *Commonwealth of Australia Government Notices Gazette*.

²¹⁸ Under water access entitlements.

²¹⁹ Under water access entitlements.

The ACCC considers that a transitional period is appropriate to allow operators subject to the tier 2 water infrastructure charge rules to make any changes to their systems to comply with the rules and to prepare their first NSP. The draft advice proposed a 12-month transition period but a number of factors have caused the ACCC to reconsider this arrangement for compliance with tier 2 rules. These factors include:

- changed arrangements for engaging a qualified engineer to review an operator's NSP, particularly if the operator chooses to have the review completed in time to make changes before the NSP is given to customers
- a possible lack of opportunity under a 12-month transition period for operators to synchronise the five-year period of the NSP with existing financial reporting years
- the desirability that operators' initial NSPs incorporate as much information as possible on the impact of the significant government funding being made available to the sector for infrastructure planning and modernisation; without this there is a risk that NSPs may become quickly out of date
- the fact that one of the tier 2 operators²²⁰ is on a regulated price path that expires on 30 June 2011.

In light of these considerations, the ACCC has decided that operators required to comply with the tier 2 rules must do so by 1 July 2011. This change has the added advantage that compliance with the tier 2 rules is not dependent on the date when the rules take effect. Six to nine months is added to the time that operators will have to comply as compared to the 12-month transition period proposed in the draft advice but the ACCC considers that the benefits outweigh the disadvantages of this delay.

Operators will be required to prepare an NSP by 1 July 2011 under the processes provided in the draft rules accompanying this advice and to provide the NSP to customers. After the transitional period, regulated water charges imposed by operators must reflect those in the NSP or as published in the schedule of fees and charges with any variations between the two explained in the accompanying information statement.

In the case of an operator that becomes a tier 2 operator after the rules take effect, the first NSP must be completed for a five-year period commencing no later than 24 months after the operator becomes a tier 2 operator.

The ACCC will develop guidelines and templates, as necessary, to assist operators to satisfy these requirements for tier 2 operators in the draft water infrastructure charge rules.

The tier 2 requirements in relation to the NCP, NSP, consultation and information statement are in Part 5 of the draft rules.

²²⁰ SunWater.

5.3.2 Monitoring and reporting requirements

Under s. 94 of the Water Act, the ACCC is required to monitor and report to the minister on regulated water charges and compliance with water charge rules.

The schedules of regulated water infrastructure charges, which all operators are required to provide to customers, will be a key input to monitoring water charges. Initially, only comparisons of charges across the Basin will be possible, but eventually it will be possible to build a picture of the movement in prices over time.

Monitoring compliance with tier 2 rules, to be undertaken by the ACCC, in the first instance will involve consideration of an operator's publicly available information, such as its schedule of fees and charges, and other forms of information, such as information statements, NSPs and consultant reports used by the operator in determining regulated fees and charges. The ACCC may request information from the operator or may require it under s. 155 of the *Trade Practices Act 1974*.²²¹ Chapter 7 discusses enforcement of the water charge rules and the application of civil penalty provisions under the Water Act and dependent rules.

²²¹ The Trade Practices Act has been amended to extend s. 155 powers to include the Water Act.

6 Determination or approval of regulated water charges

This chapter discusses the tier 3 rules concerning the determination or approval of regulated water charges. As noted in chapter 3, these requirements are expected to apply to large²²² non-member owned operators, which currently include:

- State Water
- Goulburn-Murray Water (GMW)
- Lower Murray Water (LMW).

These requirements are additional to those required under tier 1—specifically, the publishing requirements.

6.1 Overview of approach

The proposed approach for the tier 3 rules will include:

- a price approval or determination process being undertaken prior to the commencement of the regulatory period for charges in each year²²³ of the regulatory period
- annual review of charges for the second, third and fourth years of a regulatory period.

Under this process, most of the relevant information required to approve or determine charges for each year of a regulatory period would need to be provided to the ACCC 15 months before the end of a regulatory period to enable the ACCC to make a decision in time. This would include information for each year of the regulatory period on the operator's:

- consultation undertaken in developing its pricing application
- regulatory and legislative obligations
- service standards
- regulatory asset base (RAB), where relevant
- renewals annuity, where relevant
- capital expenditure

²²² 'Large' refers to operators that have an entitlement (or that service customers with a combined entitlement) of over 250 GL within the MDB to which a regulated water charge applies.

²²³ The main change in this approach from that proposed in the draft advice is that the ACCC is now proposing that it approve or determine maximum charges for each year (rather than just the first year) of the regulatory period, prior to the regulatory period commencing. In practice, the ACCC does not consider that this change will have a material effect on the approval or determination process.

- operating and maintenance expenditure
- tax liabilities
- required revenue
- demand or consumption
- regulated charges.

This information would then be used to approve or determine charges for each year of the regulatory period. The ACCC will approve charges if the corresponding required revenue is prudent and efficient and if the proposed charges contribute to achieving the Basin water charging objectives and principles. The ACCC's final decision in respect of this process would be published before the commencement of the regulatory period to which it relates and would contain charges and an indicative revenue path for each year in that regulatory period. Among other things, the ACCC's proposed approach will include measures to provide operators with the appropriate incentives to pursue efficiency in capital and operating expenditure.

For the annual review process, the operator will be required to submit to the ACCC updated demand or consumption data and updated proposed prices five months before the commencement of the second, third and fourth year of a regulatory period to enable the ACCC to make a decision in respect of that updated data, including:

- forecast demand/consumption for the upcoming year
- an estimate of actual demand/consumption for the year closing
- information on how the above items were calculated
- proposed prices for the upcoming year.

The ACCC would use this information and the charges approved in the approval or determination undertaken prior to the first year of the regulatory period (in respect of the relevant year) to approve or determine the charges for the relevant year. In this way those charges approved or determined prior to the regulatory period commencing would be adjusted for any changes in demand or consumption forecasts. This will allow operators to maintain greater revenue stability in the face of changing demand or consumption. However, in approving charges in the second, third and fourth years of a regulatory period, the ACCC will also consider whether the proposed charges will impact on price stability so as to balance the interests of the operator and its customers.

As an additional revenue stability measure, the ACCC will also consider passing through revenue shortfalls in moving from one regulatory period to the next where such shortfalls are the result of forecasting inaccuracies or an ACCC decision to limit price shocks between years.

These processes and associated issues will be discussed in more detail throughout the remainder of the chapter. In particular, the remainder of the chapter is divided into the following sections:

- approval or determination process to be undertaken before the commencement of the regulatory period

- annual variation of charges in the second, third and fourth year of a regulatory period
- commencement of the tier 3 rules
- monitoring and enforcement of the tier 3 rules.

6.2 Approval or determination undertaken before the commencement of the regulatory period

This section addresses aspects of the approval or determination process that will be undertaken before the commencement of each regulatory period under which prices for each year of the regulatory period will be approved or determined. In particular, the following issues will be discussed:

- the pricing principles against which charges will be assessed
- the application of the pricing principles—what information the ACCC will require from operators to assess the proposed charges against the pricing principles
- the treatment of existing regulatory asset base values
- efficiency incentives for capital and operating expenditure
- the length of the regulatory period
- reopening provisions
- the process.

6.2.1 Pricing principles

This section discusses factors that the ACCC will be required to consider in approving or determining regulated charges as part of the determination or approval process that will be undertaken prior to the commencement of each regulatory period.

The Water Act requires that the water charge rules must contribute to achieving the Basin water charging objectives and principles.²²⁴ This is why, in its draft advice, the ACCC recommended that in approving or determining charges, it must be satisfied that the water charges contribute to achieving the Basin water charging objectives and principles (Schedule 2 of the Water Act).

To promote the efficient use of water resources and water infrastructure,²²⁵ the ACCC also recommended that in approving or determining regulated charges, it must be satisfied that the total forecast revenue requirement reasonably reflects the efficient and prudent costs of meeting the expected demand for (or consumption of) the water supply and delivery services of the regulated water business, including any costs incurred in complying with any regulatory obligations and requirements.

²²⁴ Section 92(1)(c) of the Water Act.

²²⁵ Schedule 2, clauses 2(a)(i) and (ii) of the Water Act.

Views of interested parties

None of the submissions to the position paper or draft advice raised any specific issues about the pricing principles to be followed by the ACCC in approving or determining regulated water charges.

ACCC assessment

The water charge rules must contribute to achieving the Basin water charging objectives and principles.²²⁶

To promote the efficient and sustainable use of water resources,²²⁷ charges should:

- reflect the prudent cost of providing the water supply and delivery service, including costs associated with future supplies and periods of peak demands and/or restricted supply
- include the costs of complying with relevant laws or regulations
- be based on a principle of user pays²²⁸ so that users face the true cost of the service (subsidies and community service obligations should be eliminated or reduced over time; where they remain, they should be publicly reported)
- be made publicly available to increase transparency and allow users and potential users to compare charges across regions and use this information to make decisions as to where to locate their business, thus promoting dynamic efficiency.²²⁹

To promote the efficient and sustainable use of water infrastructure assets,²³⁰ charges should:

- reflect the prudent costs of maintaining, replacing and upgrading infrastructure, where necessary, to accommodate efficient infrastructure investment, including the upgrade and/or rationalisation of assets over time
- be based on a principle of user pays so that the costs of infrastructure investment in each service area are reflected in the charges for that area, thus promoting economically efficient investment (subsidies and community service obligations should be eliminated or reduced over time; where they remain they should be publicly reported).

In addition, to promote allocative efficiency and ensure expenditure is prudent, businesses should agree to service standards and develop forward asset management plans in consultation with customers. Service standards should be reported and linked to the proposed asset investment and any resulting adjustments to charges. This will

²²⁶ Section 92(1)(c) of the Water Act.

²²⁷ Schedule 2, clause 2(a)(i) of the Water Act.

²²⁸ Schedule 2, clause 2(d) of the Water Act.

²²⁹ Schedule 2, clause 2(d) of the Water Act.

²³⁰ Schedule 2, clause 2(a)(ii) of the Water Act.

allow customers to understand how service standards relate to infrastructure investment and ultimately to the level of charges. This should foster efficient and sustainable investment in water infrastructure assets.

To ensure sufficient revenue streams to allow for the efficient delivery of the required services,²³¹ charges should be based on full cost recovery²³² so that the business is able to recover its efficient costs and continue to supply the service over time. This includes recovery of:

- operational, maintenance and administrative costs (including tax)
- expenditure on renewing and rehabilitating existing assets
- a rate of return on capital.

In summary, the ACCC recommends that, in order to approve or determine charges, it must be satisfied that the total forecast revenue for each year of the regulatory period recovers the prudent and efficient costs of providing the service, including costs incurred in complying with regulatory obligations and requirements.

The asset base upon which operators earn a return is a key factor in determining the level of charges. For this reason, in approving or determining charges, the ACCC will also be required to ensure that operators set their asset base in accordance with an accepted methodology and that, once set, the asset base is only adjusted to account for actual investment by the operator, depreciation and any revenue from asset sales. This requirement is discussed in more detail in section 6.2.3.

In addition, the ACCC, when deciding whether to approve charges or when determining charges, must also have regard to whether the regulated charges contribute to achieving the Basin water charging objectives and principles set out in Schedule 2 of the Water Act.

Tier 3 operators will have discretion in how they set regulated charges, subject to the matters outlined in rule 29 of the draft rules, including the requirement that forecast revenue recovered in totality from regulated charges does not exceed the efficient and prudent costs of providing infrastructure services for each year of the regulatory period. This will provide scope for operators to accommodate price paths for the provision of infrastructure services that may be specified under existing contracts.

These are the principles that the ACCC will be required to consider in approving or determining charges before the beginning of a regulatory period.

The pricing principles for approvals or determinations in respect of each year of the regulatory period are contained in rule 29, Division 2, Part 6 (and Schedule 2) of the draft rules.

²³¹ Schedule 2, clause 2(b) of the Water Act.

²³² Schedule 2, clause 3(3) of the Water Act.

6.2.2 Application of the pricing principles—what information is required from operators?

This section discusses the implementation of the pricing principles and the associated information required from tier 3 operators as part of the approval or determination process to be undertaken prior to the commencement of each regulatory period.

In order to assess charges and forecast revenues against the above criteria, the ACCC will require certain information from operators. Specifically, in support of an application to the ACCC to determine or approve an operator's regulated charges, the operator will be required to provide information on its:

- consultation processes around service standards and obligations
- approach to capital financing
- past and forecast capital expenditure including key projects and expenditure drivers
- operating and maintenance expenditure
- required revenue
- demand forecasts
- charges and tariff structures.

These information requirements are consistent with those of other regulators, including that requested of water businesses regulated by the Essential Services Commission (ESC) in Victoria and the Independent Pricing and Regulatory Tribunal (IPART) in New South Wales.

To assist operators in complying with these requirements, the ACCC proposes to develop information guidelines and templates in consultation with interested parties.

Views of interested parties

The only comments made in submissions to the position paper on this issue were made by State Water.

State Water recommended that:

... references to demand forecasts in the water charge rules should be amended to refer to consumption forecasts as well as demand forecasts.²³³

In relation to service standards, State Water noted:

State Water has limited discretion to vary service delivery through asset investment ... State Water has no formal relationship directly with a user of water, whose licence is issued by DWE [New South Wales Department of Water and Energy] on behalf of the Minister for Water ...

Consequently, consultation on service standards with customers is primarily for nondiscretionary services which for the most part relate to operating expenditure, such

²³³ State Water, submission to the ACCC water charge rules position paper, November 2008, p. 3.

as the level of operations planning information provided to customers. The exception to this is specific asset enhancements such as water efficiency projects or additional gauging stations which are agreed with the valley based Customer Service Committees. The templates provided by the ACCC should allow for this difference.²³⁴

State Water also raised a number of issues about the use of a post-tax (versus pre-tax) weighted average cost of capital (WACC) and the ACCC's preferences in terms of tariff design.

State Water requested the ACCC to develop pricing methodology guidelines to assist compliance:

State Water believes that it will be useful for the ACCC to release pricing methodology guidelines to assist businesses in developing submissions which are more likely to be deemed by the ACCC as consistent with the water charge rules.²³⁵

State Water again made comments on this issue in its submission to the draft advice:

The ACCC has indicated it will release 'price methodology guidelines' on how operators should address various inputs to prices. State Water understands these guidelines will be flexible arrangements and will allow operators to deviate from the guidelines under justifiable circumstances. State Water welcomes the introduction of guidelines and templates to assist operators in complying with their regulatory obligations. State Water agrees that operators should be consulted on the development of the guidelines.²³⁶

ACCC assessment

As mentioned above, in order to approve or determine charges, the ACCC must be satisfied that the total forecast revenue for each year of the regulatory period recovers the prudent and efficient costs of providing the service including costs incurred in complying with regulatory obligations and requirements.

In assessing the above, the ACCC must also have regard to whether the regulated charges contribute to achieving the Basin water charging objectives and principles set out in Schedule 2 of the Water Act.

In order to assess whether these conditions are met, the ACCC will require certain information from the tier 3 operators as part of the application process. In particular, the pricing application should provide details on the operator's:

- consultation undertaken in developing its pricing application
- regulatory and legislative obligations
- service standards
- RAB, where relevant

²³⁴ *ibid.*

²³⁵ *ibid.*, p. 2.

²³⁶ State Water, submission to the ACCC water infrastructure charge rules draft advice, May 2009, p. 2.

- renewals annuity, where relevant
- capital expenditure
- operating expenditure
- tax liabilities
- required revenue
- demand or consumption
- regulated charges.

This information is typical of what is required by most Australian regulators of their regulated businesses. In Victoria, for example, the ESC requires regulated water businesses to submit water plans in advance of the regulatory period; these plans include information on customer consultation, guaranteed service levels, regulatory and government obligations, operating and capital expenditure, the financing of capital expenditure, forecast tax liability, demand forecasts, prices and non-prescribed services.

Similarly, IPART requires State Water to provide information on, among other things:²³⁷

- actual capital and operating expenditure over the current determination period
- projected capital and operating expenditure over the upcoming determination period, drivers of this expenditure and expected service outcomes to be achieved
- the value and timing of any contributions to or from government
- forecast water sales and customer numbers and the reasoning and assumptions behind these forecasts
- common or joint costs and the means of allocating these to geographical areas and customers.

The proposed components of the pricing application are discussed in more detail below.

Consultation

To assess whether the expenditures and charges proposed in an operator's pricing application are prudent, it will be important for the ACCC to consider whether the operator has consulted on its application and, if so, what feedback it has received from customers. The operator will be required to include in its pricing application a statement about whether it consulted on its proposals and, where it did consult, details of the extent and nature of the consultation process, including matters consulted on and customer feedback received.

Regulatory and legislative obligations

In providing water services, operators are likely to have a number of obligations required of them under state or federal acts, legislative instruments or licences. These

²³⁷ IPART, submission to the ACCC issues paper on bulk water charge rules, July 2008, p. 11.

could require an operator to undertake certain projects requiring capital or operating expenditure to meet its necessary obligations. To assess whether the associated expenditure is prudent, the ACCC will need to know the operator's reason for undertaking the project.

The ACCC will require details of all regulatory and legislative obligations applying to the operator that are likely to affect the level of regulated water charges. These should be provided for the period that is set to expire and for the next regulatory period to which the application relates. In particular, the operator should highlight any changes in these between the two regulatory periods.

Service standards

As with regulatory and legislative obligations, it will be important for the ACCC to have information on the operator's service standards. The ACCC will require information about an operator's service standards because these are likely to be a key cost driver for the operator. In particular, the ACCC will be interested in obligatory minimum standards or any standards proposed in consultation with customers. This could include minimum standards for key performance indicators or performance targets.

These details will be used to assess whether any associated expenditure is prudent. For example, where the expenditure represents increased levels of service above any minimum standard, this should be supported by customers. It will also improve transparency and allow customers to make the connection between the service they receive and the price they pay.

Details of service standards should be provided for each year of the period that is set to expire and the next regulatory period to which the application relates. The operator should also highlight any changes in these between these two periods.

Regulatory asset base

Operators may recover the cost of financing existing and new investments through:

- earning a return on the value of the RAB (that is, the WACC multiplied by the RAB)
- a return of the value of the RAB (that is, regulatory depreciation).

At the start of a regulatory period, the value of the RAB needs to be updated to reflect the value of actual efficient and prudent capital expenditure, customer and government contributions and disposals undertaken in the previous regulatory period. The ACCC proposes that operators provide details showing the calculation of the value of the RAB across the regulatory period. The ACCC will also need details of the operator's proposed rate of return and regulatory depreciation.

Overall, where an operator uses an RAB approach to fund capital expenditure, the ACCC will require the following information in the operator's pricing application:

- the level of contributions from customers and government and the assumptions underpinning those forecasts

- the proceeds from asset disposals and the nature and type of the assets anticipated to be sold
- the regulatory depreciation of assets and the reasons for this
- details of the rate of return proposed by the operator and the basis for the proposed rate of return
- from the above, the actual or forecast value of the RAB.

This information should be provided for each year of the regulatory period that is set to expire and for the next regulatory period to which the application relates.

These will be assessed to ensure full cost recovery,²³⁸ to establish whether charges are moving towards upper bound pricing²³⁹ and to ensure that actual and forecast capital expenditure (which is, or will be, incorporated into the RAB) is prudent and efficient.

The value of the initial RAB is discussed in the following section.

Renewals annuity

None of the existing tier 3 operators (GMW, State Water and LMW) operate a renewals annuity approach. However, other operators could be subject to the tier 3 rules in the future (for example, because of mergers), and for this reason the rules need to address the ACCC's approach to renewals annuities. This section explains the factors the ACCC would take into account in considering an operator's renewals annuity.

The ACCC proposes that operators using a renewals annuity should set out the proposed renewals amount and the assumptions used to calculate it. This information—to be provided annually for the period that is set to expire and for the next regulatory period to which the application relates—would include:

- the nature of the assets included in the annuities calculation
- the basis of the long-term capital expenditure forecasts that support the calculation—when and on what basis the forecasts were made
- the service levels that underpin the capital expenditure forecasts, linked to the earlier discussion of service levels
- the annuity term
- the discount rate used to calculate the annuity
- from the above, the actual or forecast balance of the renewals annuity.

Where a business proposes to move away from a renewals approach to an RAB approach, it should explain how it proposes to manage the change. This is particularly important where a business has a positive balance in its renewals reserve, implying that customers have already made a contribution to costs that will be incurred in the future. In such circumstances, operators should set out the balance of the renewals reserve

²³⁸ Schedule 2, clause 3(3) of the Water Act.

²³⁹ Schedule 2, clauses 3(4) and (5) of the Water Act.

each year and a detailed explanation of the manner in which the funds are to be returned to customers—for example, through immediate offsets to prices in the next regulatory period or, alternatively, through assumed offsets to future capital expenditure. The ACCC expects the operator to have consulted on these options.

Capital expenditure

Capital expenditure is a key component of the revenue requirement and hence can have a substantial bearing on the level of charges. The ACCC proposes to assess the efficiency of expenditure forecasts put forward by operators as well as the incentives available to operators to engage in efficient expenditure over time.

To assess whether capital expenditure is efficient and prudent, the ACCC will require information on the level of the expenditure and the cost driver to which the expenditure relates. In particular, the operator should include information—for each year of the regulatory period that is set to expire and the next regulatory period to which the application relates—on the following:

- capital expenditure
- the major projects over the period including the cost and timing of these projects
- the expected outcomes of these projects and their key driver—growth, renewal of existing infrastructure, service improvements or compliance with regulatory obligations
- evidence that the expected levels of expenditure are prudent and efficient—for example, the results of an independent engineer’s assessment.

Where operators rely on other information—for example, benchmarking studies—to support their forecasts, they should also provide an overview of this information. Detailed information underpinning all forecasts should be kept by the operator and be made available to the ACCC on request. In general, the ACCC is likely to request more evidence when an operator proposes a significant increase or decrease in expenditure or where expenditure relates to delivering outcomes above and beyond what is mandated by customers, legislation or regulation.

The ACCC is also mindful of providing appropriate incentives for efficient capital expenditure. This is discussed in more detail below.

Operating expenditure

Like capital expenditure, operating expenditure is a key component of the revenue requirement and can have a substantial influence on the level of charges.

To ensure that charges are set at an efficient level, the ACCC will be required to assess whether the operator’s proposed expenditure is prudent and efficient. To facilitate this, the operator should include information in its pricing application—for each year of the regulatory period that is set to expire and the next regulatory period to which the application relates—on the following:

- operating expenditure

- the key drivers of the expenditure—growth, renewal of existing infrastructure, service improvements or compliance with regulatory obligations
- a justification of the actual or forecast operating expenditure
- evidence of productivity improvements.

As with capital expenditure, where the operator has used supporting information to forecast operating expenditure, details of this should be provided. The ACCC is mindful of developing a regulatory framework that provides the appropriate incentives for efficient operating expenditure. This is discussed in more detail below.

Tax liabilities

Under the ACCC's proposed approach to determining the revenue requirement, operators would be able to directly recoup the cost of company tax during the regulatory period. Thus, the ACCC would expect operators to set out details of their tax payments—on an annual basis for the period set to expire and for the next regulatory period to which the application relates—in their pricing applications to the ACCC.

Required revenue

An operator's required revenue should be derived from its:

- RAB or renewals annuity, whichever is relevant
- capital expenditure
- operating and maintenance expenditure
- tax liabilities.

These factors will determine how much revenue the operator will be required to recover in order to continue to provide the required level of water infrastructure related services over the regulatory period. The revenue requirement is then used to calculate charges, subject to forecast demand (or consumption).

Demand or consumption forecasts

The proposed charges in an operator's pricing proposal depend, among other things, on the forecast demand (also referred to as consumption) for the operator's services. The ACCC proposes that operators provide information to help it determine whether demand forecasts are reasonable and whether, based on the estimates of demand, the operator is likely to recover sufficient revenue.²⁴⁰ Such information would include:

- details of the operator's actual demand or consumption for each year of the regulatory period that is set to expire
- details of the operator's demand or consumption for each year of the next regulatory period to which the application relates, including:
 - forecast demand or consumption
 - a description of the methodology used to forecast demand or consumption

²⁴⁰ Schedule 2, clause 2(b) of the Water Act.

- assumptions on which the forecasts are based
- consistency with historical data.

Regulated charges

To approve an operator's charges, the ACCC will require details of those charges. Further, it will be necessary for the ACCC to assess whether the charges will contribute to achieving the Basin water charging objectives and principles. Specifically, the pricing application should include:

- details of the operator's regulated charges for each year of the regulatory period set to expire
- details of the operator's proposed regulated charges for each year of the next regulatory period to which the application relates.

Operators should also identify material changes to proposed charges between years and provide clear links between the proposed changes and their drivers—such as new obligations or network modernisation—and material changes in their revenue requirement. The pricing application should also identify the customer impact of any proposed tariff changes.

Information guidelines and templates

Information guidelines and templates will be developed by the ACCC in consultation with interested parties following the introduction of the rules. These will be completed before the ACCC undertakes its first approval or determination. These guidelines and templates will provide detail on the specific information required from operators as part of their application to have their charges approved or determined by the ACCC.

The ACCC will also develop price methodology guidelines, covering but not limited to:

- in approving or determining charges, what form of WACC is likely to be appropriate
- what efficiency incentive schemes should be built into the regulatory framework (see section 6.2.4)
- what tariff structures, if any, are likely to be appropriate
- in approving or determining charges, what cost allocation methodologies should be used for allocating costs across users—including methodologies concerning user and government shares for funding regulatory and legislative obligations.

Apart from providing guidance to regulated operators, these guidelines will demonstrate the factors the ACCC will be likely to consider when assessing pricing applications against the pricing principles.

The ACCC notes that a number of interested parties have raised specific issues that will be addressed through the price methodology guidelines. In particular:

- how to allocate costs between users and the government—IPART's submission to the position paper

- how the WACC will be determined—State Water’s submission to the position paper and draft advice and Gwydir Valley Irrigators Association’s (GVIA’s) submission to the draft advice
- the impact of different tariff structures—GVIA’s submission to the draft advice.

These comments will be considered in the context of developing the price methodology guidelines.

The information required from tier 3 operators prior to the commencement of each regulatory period is contained in Schedule 1 of the draft rules.

6.2.3 Treatment of existing RAB values

This section addresses the issue of whether to retain existing RAB values. In the position paper and draft advice, the ACCC recommended that it retain any RAB value in place at the time at which it commences approvals or determinations for an operator.

Views of interested parties

IPART and the Queensland Government made comment on this issue in response to the position paper.

IPART noted:

IPART supports recognition of State Water’s Regulatory Asset Base (RAB)—particularly given IPART’s detailed investigation and public review in its 2006 determination of State Water’s prices.²⁴¹

... IPART notes that if a common approach is not adopted to setting the initial value of RABs across the Basin and all RABs are simply taken by the ACCC as given, the aims of consistency in approach, cost recovery, and ultimately economic efficiency could be compromised ...

IPART therefore recommends that the water charge rules provide scope for the ACCC to review and, where necessary, amend opening RAB values where warranted. Further, to ensure consistency between Basin jurisdictions, IPART considers that a common starting date for the development of all RABs should be used.²⁴²

The Queensland Government noted:

Queensland welcomes the ACCC’s consideration in the text of the Position Paper that any regulatory asset base value in place at the time the ACCC commences its first determination or approval for the operator be retained. This would be important to ensure that there are no major price shocks due to changes in the value of the asset base at the commencement of the new regulatory period.²⁴³

²⁴¹ IPART, covering letter to its submission to the ACCC water charge rules position paper, November 2008, p. 2.

²⁴² *ibid.*, p. 6.

²⁴³ Queensland Government, submission to the ACCC water charge rules position paper, December 2008, p. 2.

In response to the draft advice, GVIA noted:

GVIA is comfortable with the [State Water] RAB determined by IPART and would therefore be supportive of this RAB being brought forward into future determination processes ...

GVIA is not comfortable that other jurisdictions have been as rigorous in developing their RAB, and therefore suggests that the price determiner/approver reviews all RABs to ensure that they will contribute to consistent pricing across jurisdictions.²⁴⁴

ACCC's assessment

The ACCC has previously noted that an RAB value, once set, should not be subject to revaluation except under certain unforeseen circumstances. Revaluation of an existing RAB can create uncertainty for the regulated business and its customers and can result in price shocks and windfall gains or losses to the business.

For these reasons, the ACCC recommends that any RAB value in place at the time that the ACCC commences its first price approval or determination for an operator should be retained.

In response to comments made by IPART and GVIA, it is understood that the various jurisdictions used different methodologies to value the RAB when operators in these jurisdictions moved away from a renewals annuity approach. However, a number of methodologies are available and all of these are technically acceptable. In addition, revaluation of an RAB can result in perverse or unintended consequences. In weighing up these issues, the ACCC has assessed that it should retain any RAB values in place when it commences approvals or determinations for an operator.

In particular, when the ACCC undertakes its first approval or determination for a tier 3 operator, the value of the RAB will be calculated by starting with the RAB value determined in the previous regulatory period, adjusted for any assets that do not relate to the provision of infrastructure services and rolled forward for any capital expenditure (net of customer or government contributions), depreciation and asset disposal from the previous regulatory period. The RAB will then be rolled forward in this way for each subsequent regulatory period.

Where an operator moves into tier 3 and it has not yet had the value of its RAB determined for the purposes of price setting prior to the ACCC commencing regulation of its charges, its initial RAB will be set by the ACCC using an accepted valuation methodology. In subsequent regulatory periods, the RAB will then be rolled forward to account for adjustments in capital expenditure, depreciation and disposals as above. The draft rules include rules that require the ACCC to calculate the initial and subsequent RAB values in these ways.

The ACCC notes State Water's concerns that the ACCC may use a different WACC from that used by IPART and that this could result in a revenue shortfall for State Water. State Water suggested that to address this concern the ACCC should revalue

²⁴⁴ GVIA, submission to the ACCC water infrastructure charge rules draft advice, May 2009, p. 4.

State Water's RAB. As mentioned above, the ACCC does not believe that RAB values should be subject to revaluation. However, should a revenue shortfall exist, the ACCC may pursue other adjustment measures where such adjustments are considered appropriate.

The requirements for calculating the RAB are contained in rule 29 and Schedule 2 of the draft rules.

6.2.4 Efficiency incentives

In regulating a natural monopoly business, the regulator will almost always have access to less information than the regulated business. In the presence of this information asymmetry, it is preferable to provide the business with a substantial amount of discretion, while developing a regulatory system that provides the appropriate incentives for the business to pursue desirable outcomes.

In particular, the regulatory framework should provide the business with the appropriate incentives to only commit such capital and operating expenditure as is necessary to provide the required services.

Efficiency incentive for capital expenditure

In undertaking an approval or determination, the ACCC will (among other things) assess the operator's proposed capital expenditure for the entire regulatory period before that expenditure is undertaken. It will be an ex ante approval process whereby capital expenditure projects are effectively pre-approved by the ACCC.

In this way, there will be a lag between the time when the expenditure is undertaken and the time when the regulatory asset base is updated for actual capital expenditure. Charges in the period during which the expenditure is actually incurred will be set on the basis of the forecast capital expenditure that the ACCC has pre-approved before the commencement of the regulatory period. Where the operator can deliver the capital project for less than the forecast cost of the project, the operator will be able to recover the difference between the forecast and actual capital expenditure through charges until the start of the next regulatory period (when the regulatory asset base is adjusted for actual expenditure).

At the start of the next regulatory period, the regulatory asset base will be adjusted by the actual amount of capital expenditure and, in this way, if the operator has been able to spend less than the forecast amount, the customers will also benefit through lower prices.

In this way, ex ante treatment of capital expenditure can provide benefits to the operator, before the end of the regulatory period, and benefits to the customers, after the regulatory asset base is updated for actual capital expenditure.

Efficiency incentive for operating expenditure

Because operating expenditure is forecast at the start of the regulatory period, spent during the regulatory period and reviewed at the end of the regulatory period, the same incentives exist as for capital expenditure. Namely, if the operator is able to spend less

than the forecast amount of operating expenditure, it will be able to recover through prices the difference between the actual and forecast operating expenditure.

In this way, operators are faced with the incentive to spend less than the forecast level of operating expenditure so that they can recover the difference between the forecast and actual operating expenditure through charges.

To add an additional incentive, the ACCC could introduce an efficiency carry-forward mechanism whereby the operator would be able to carry forward any surpluses (or deficits) between actual and forecast expenditure for a set period of time. For example, any underspending (or overspending) in relation to operating expenditure in any given year could be brought forward for the next three or four years (depending on the length of the regulatory period). Each year a running surplus or deficit would be accounted for, adjusting for inflation, and when each new regulatory period commenced these cumulative amounts would be added to the operating expenditure forecast on which charges are set.

At the expiry of the three or four years any remaining surplus would be written off, resulting in lower charges for customers. In this way, any efficiency savings in relation to operating expenditure would be shared between the operator and the customer over time.

The ACCC will work with stakeholders in further developing these expenditure efficiency schemes as part of the ACCC's proposed price methodology guidelines.

6.2.5 Length of the regulatory period

This section addresses the issue of how long the regulatory period should be, both initially and on an ongoing basis.

As a transitional measure, the ACCC recommended that the initial regulatory period should be limited to three years. The length of future regulatory periods would then be set at four years. This represented a change from the position paper where it was recommended that the length of subsequent periods would be set by the ACCC as part of the approval or determination process but would be between three and five years.

Views of interested parties

The following comments were received in response to the position paper.

State Water suggested that approvals or determinations be undertaken concurrently for all tier 3 operators:

... in determining revenue requirements and water charges the ACCC will effectively making decisions on various key inputs to pricing such as user cost shares and WACC [Weighted Average Cost of Capital] rates. As these elements of pricing are common to all utilities, it is reasonable to assume that the ACCC will require them to be consistent

across the jurisdictions ... State Water therefore believes that all bulk water charge determinations should be undertaken concurrently.²⁴⁵

However, the National Farmers' Federation (NFF) recommended:

... that the ACCC ensure that the pricing paths between Tier 3 operators are staggered to smooth the workload and ensure little or no impacts on irrigator planting and or trade decisions.²⁴⁶

State Water noted:

The water charge rules are largely consistent with the approach that IPART already uses to determine State Water prices, and therefore the transition is unlikely to be as difficult for State Water as it would be for other utilities. Therefore State Water believes that the rules should provide the option for the initial period to be longer than three years due to the level of resources required to undertake a Determination.²⁴⁷

The NFF and NSW Irrigators' Council (NSWIC) supported the proposed regulatory period:

NFF supports the proposed regulatory period.²⁴⁸

NSWIC concurs with the ACCC view that initial price setting periods should be three years and later between three and five years.²⁴⁹

In response to the draft advice, LMW noted:

The current proposal in the Water Infrastructure Charge Rules – Draft advice is to place LMW into the Tier 3 business category which will have a 4 year regulatory cycle for irrigation based functions. The remaining urban based functions will still be based on the ESC 5 year regulatory period.

This misalignment of regulatory periods will create major administrative complexities leading to business inefficiencies and cost imposts in accounting around different regulatory periods. This is highlighted in the distribution of corporate costs across all functions particularly where revenue cap tariffs are in place.²⁵⁰

ACCC assessment

In setting the duration of the regulatory period, the ACCC considered the trade-off involved in setting shorter or longer periods. In particular:

- Over a shorter period there is greater certainty around expenditure and demand forecasts.

²⁴⁵ State Water, submission to the ACCC water charge rules position paper, November 2008, p. 4.

²⁴⁶ NFF, submission to the ACCC water charge rules position paper, December 2008, p. 7.

²⁴⁷ State Water, op. cit., p. 4.

²⁴⁸ NFF, op. cit., p. 6.

²⁴⁹ NSWIC, submission to the ACCC water charge rules position paper, November 2008, p. 5.

²⁵⁰ LMW, submission to the ACCC water infrastructure charge rules draft advice, May 2009, p. 2.

- A longer regulatory period will provide greater price certainty to customers.
- The approval or determination period is costly and should only be repeated as required.
- The duration of the regulatory period should be long enough to allow the regulator and regulated businesses to undertake all steps of the process including appropriate consultation.

Generally, the more uncertainty there is, the stronger the argument for a relatively short regulatory period. Otherwise there is an increased likelihood of unanticipated outcomes for the operator or its customers. But if there is a reasonable degree of certainty in the outlook period, a longer determination period is warranted.

Five years is a typical price determination period and is used by Ofwat and Ofgem (for water, electricity and gas price control in the United Kingdom), the Australian Energy Regulator (AER) (in the national electricity market) and the ESC (for Victorian urban and rural water and gas). However, the ESC effectively undertakes annual price approvals or determinations for rural water businesses relying predominately on the information received at the start of the regulatory period.

The regulatory period for State Water price determinations undertaken by IPART have varied from one to four years. In other sectors, IPART uses a three-year determination period for retail electricity tariffs and annual reviews for urban transport charges (taxi, rail and bus).

To the extent that the sector is transitioning to a new regulatory framework, there is an argument for shorter regulatory periods during the transitional phase and longer periods when certainty increases and operators and their customers have adjusted to the changed circumstances.

Given these factors, the ACCC recommends that the initial regulatory period should be limited to three years and that all subsequent periods be set at four years. This differs from the recommendation in the position paper that the ACCC be able to determine the length of all subsequent regulatory periods. Allowing flexibility in the length of the regulatory period would have provided the ACCC with the ability to consider current factors when deciding on the length of the regulatory period.

However, the ACCC considers that providing a set regulatory period in the rules will give more regulatory certainty to the regulated businesses, their customers and other interested parties. The ACCC also believes that a period of three years initially and four years on an ongoing basis should strike a good balance between obtaining more accurate data, providing certainty to customers and reducing the compliance costs to the regulated operators.

The one exception to this general rule will be for operators that are also subject to price regulation in respect of their urban business by another economic regulator. For example, it is proposed that Lower Murray Water will be subject to rural water charge regulation by the ACCC and urban water charge regulation by the ESC. In such circumstances, the draft rules provide for the ACCC to align the length of the operator's regulatory period with that determined by the other economic regulator. This

should reduce the compliance costs associated with such operators being subject to two regulatory frameworks.

The length of the regulatory period is defined in rules 3 and 24 of the draft rules.

6.2.6 Reopening provisions

In response to the position paper, State Water recommended that the rules should include a provision for the ACCC to reopen a determination mid-term. In response to State Water's submission to the position paper, the ACCC introduced a mechanism which would allow for a determination or approval to be varied in the case of unforeseen and materially adverse circumstances. The proposed reopening provisions would apply where those circumstances caused the operator to undertake substantial capital expenditure to rectify the effects of those circumstances.

Views of interested parties

In its submission to the position paper, State Water noted:

... the tier 3 rules do not include any mechanism to either modify or prematurely end an existing determination. These mechanisms provide the regulator with the flexibility to respond to unforeseen circumstances. For example, IPART [New South Wales Independent Pricing and Regulatory Tribunal] recently opened the Sydney Water Determination to include the costs of the desalination plant. State Water recommends that the rules incorporate methods to address unforeseen circumstances related to pricing outcomes during the regulatory period.²⁵¹

In response to the draft advice, State Water further noted:

State Water is generally supportive a *force majeure* type exclusion during the regulatory period to reflect extenuating circumstances (Rule 39). While State Water recognises that incentives need to be in place to prevent the abuse of such a clause, the ACCC's favoured scenario ... lacks flexibility to allow for the full range of circumstances that could occur. State Water therefore recommends that the criteria for exclusion should relate to material variations which will have a material adverse impact on the financial position of the operator. Under a more flexible approach the ACCC would be given discretion to decide whether or not operators are able to legitimately declare extenuating circumstances.²⁵²

ACCC assessment

The ACCC supports the inclusion of a reopening provision in the rules. However, such a provision should only be used to vary an approval or determination in the case of unforeseen or extenuating circumstances. However, in response to State Water's comments at the public forum and in its submission to the draft advice, the ACCC is extending the provision to apply for both capital and operating expenditure (or more generally, expenditure).

²⁵¹ State Water, op. cit., p. 3.

²⁵² State Water, submission to the ACCC water infrastructure charge rules draft advice, May 2009, p. 2.

The rules will provide that operators may write to the ACCC to request that an approval or determination be varied. The ACCC would then only consider varying the approval or determination where:

- an event beyond the operator's control materially affects the operator and the event could not reasonably have been foreseen by the operator when its charges were approved or determined
- the provider proposes to undertake expenditure to rectify the adverse consequences of the event
- the total expenditure required during the remainder of the current regulatory period to rectify the adverse consequences of the event:
 - exceeds 5 per cent of the value of the regulatory asset base for the relevant operator for the first year of the current regulatory period
 - is such that, if undertaken, it is reasonably likely (in the absence of any other reduction in capital expenditure) to result in the total expenditure for the current regulatory period exceeding the total forecast expenditure for the current regulatory period
- the provider can demonstrate:
 - that it is not able to reduce expenditure in other areas to avoid the consequence referred to above without materially adversely affecting the reliability and safety of the operator's network or the operator's ability to meet any relevant regulatory or legislative obligations
 - failure to rectify the adverse consequences of the event would be likely to materially adversely affect the reliability and safety of the relevant operator's network or the operator's ability to meet any relevant regulatory or legislative obligations.

An application made under this provision would need to detail the reasons for the variation with reference to the above and must include details of the operator's proposed response to the event and what variations to the approval or determination are required.

The ACCC would have to make a decision within three months (or an extended period) of receiving the operator's application on whether to approve or reject the variation to the determination or approval. Upon making its decision, the ACCC would be required to give the operator a written notice of its decision which stated its decision and the reasons for its decision.

This approach is consistent with that of other economic regulators. For example, in regulating electricity transmission network service providers, the AER allows for revenue caps to be reopened.²⁵³ In addition, the ESC has a number of conditions under which an approval or determination can be reopened.²⁵⁴

²⁵³ ACCC, *Statement of principles for the regulation of electricity transmission revenues*, December 2004.

²⁵⁴ ESC, *Goulburn-Murray Water Determination: 1 July 2008 – 30 June 2013*, 2008 Water Price Review, June 2008.

The reopening provisions are provided for in Division 4 of Part 6 of the draft rules.

6.2.7 Process for approvals or determinations

This section outlines the processes that the ACCC and regulated operators will be required to follow in undertaking (or being subject to) price approvals or determinations prior to the commencement of each regulatory period.

The position paper and draft advice proposed that the main steps in the process for applying for, and making, approvals or determinations, will comprise the following:

- The operator submitting a pricing application to the ACCC by 1 April of the penultimate year of the regulatory period.
 - The application must contain the information required under the rules (section 6.2.2 of the advice and Schedule 1 of the draft rules).
 - Non-confidential parts of the application and supporting documentation will be made available on the ACCC website for stakeholder comment.
- The ACCC publishing a draft decision—a draft determination or approval.
 - This will be made available on the ACCC website and interested parties will have an opportunity to make submissions, which will also be made available (except where confidential).
- The ACCC publishing its final decision—a determination or approval.

This draws on the approaches of other regulators—the ESC, IPART, the Essential Services Commission of South Australia (ESCOSA) and the AER—in undertaking determinations or approvals in regulating water and other natural monopoly industries.

Views of interested parties

The following comments were received in response to the position paper.

In relation to the timing of approvals or determinations, the NFF noted the following:

NFF notes that there is no real discussion to ensure that pricing paths are finalised and in place prior to 1 July in the year that the prices are to apply. This is extremely important to irrigators to allow them to make planting or trade decisions based on the charges that will apply in that year.²⁵⁵

The NFF made a number of other comments about the proposed process:

NFF largely concurs with the outlined process. However ... NFF suggests that the consultant's report needs to be provided to stakeholders before their submissions are required to be received. Therefore, the process for the consultant's reports needs to advance ahead of this time. NFF suggests that the consultant's report be published and

²⁵⁵ NFF, op. cit., p. 6.

available on the website between the ACCC publishing the application and supporting documentation and submissions are received.²⁵⁶

NFF would support a public forum process via hearings and/or roundtable. This provides an opportunity for stakeholders, the regulator and the operator to better engage in the pricing process. This formal stakeholder engagement must be incorporated into price determinations.²⁵⁷

IPART also noted the importance of public hearings:

IPART [New South Wales Independent Pricing and Regulatory Tribunal] suggests that a public forum (in the form of a workshop or hearing) should generally be a standard (rather than ‘optional’) component of the price determination process.²⁵⁸

NSWIC submitted:

... the ACCC should formally identify a period of not less than 8 weeks during which stakeholder consultation and feedback must be sought.²⁵⁹

State Water made the following comments in response to the draft advice:

In the event of a delayed determination, the ACCC proposes that water charges be based on those from the previous regulatory period for the first six months ... After this initial extension, if no determination has been reached, the ACCC has proposed that operators not be allowed to charge any price at all until a determination is reached.

State Water is ... concerned that such a punitive rule will disadvantage operators unfairly if delays are caused by forces outside their control ...

State Water encourages the ACCC to consider an approach that both discourages tardy operators, but also does not disadvantage them when there are legitimate/extreme reasons for delays.²⁶⁰

ACCC’s assessment

The ACCC’s proposed process for undertaking approvals or determinations prior to the commencement of a regulatory period is shown in chart 6.1.

²⁵⁶ *ibid.*, pp. 6–7.

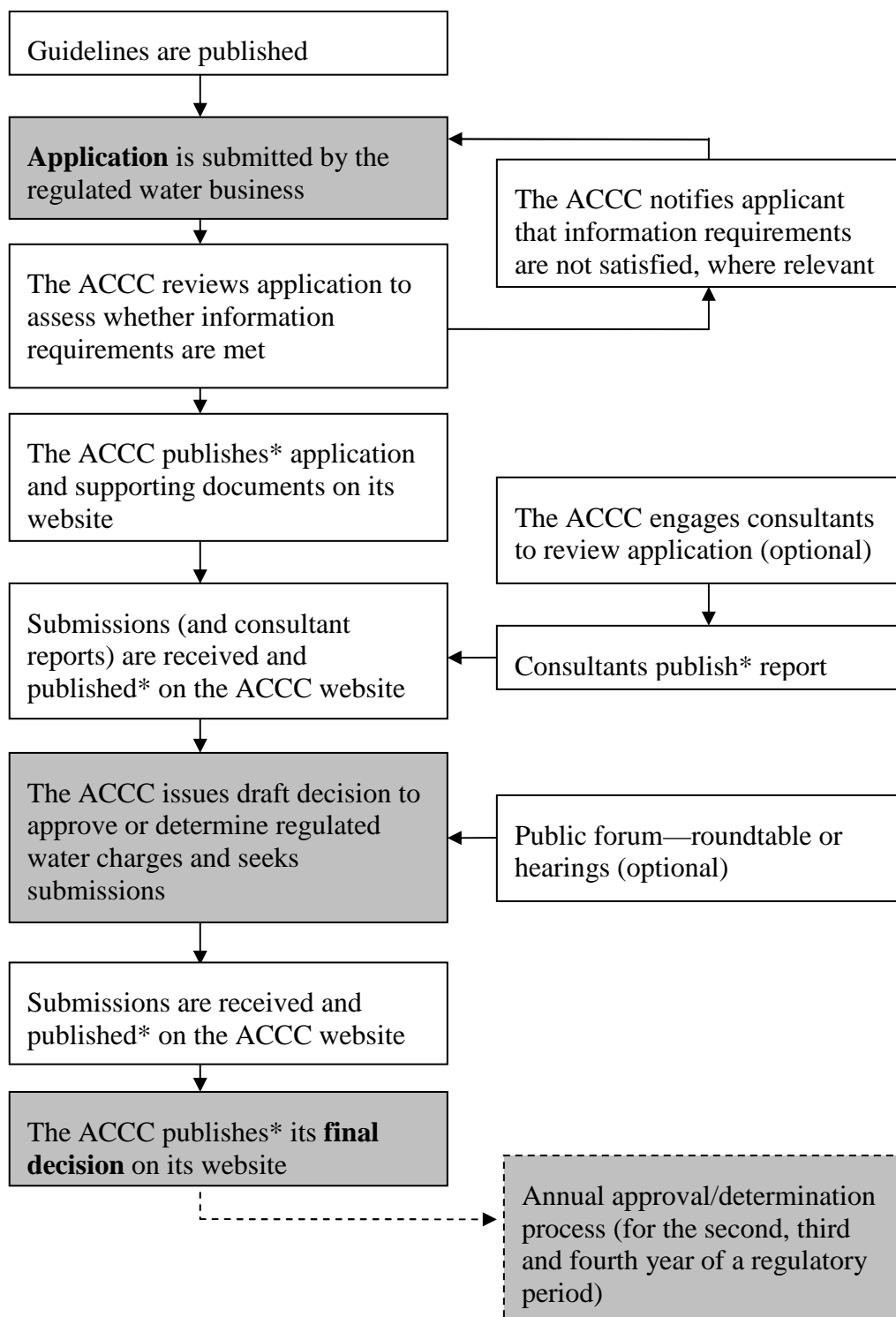
²⁵⁷ *ibid.*, p. 7.

²⁵⁸ IPART, submission to the ACCC water charge rules position paper, November 2008, p. 9.

²⁵⁹ NSWIC, *loc. cit.*

²⁶⁰ State Water, *op. cit.*, pp. 2–3.

Chart 6.1 Process for price approvals/ determinations prior to the commencement of a regulatory period



* Subject to confidentiality

Under these arrangements, the operator should submit an application to the ACCC 15 months before the expiry of the current regulatory period to allow the ACCC

13 months to make its decision. This application must comply with the information requirements set out in section 6.2.2 (and Schedule 1 of the draft rules).

On receiving an operator's pricing application, the ACCC will:

- review the application for compliance with the information requirements
- review any requests that all or part of the application remain confidential.

In the case that the ACCC is not satisfied with the information provided as part of the application, the ACCC will provide a written notice to the operator requesting further information. The operator will then be required to provide further information to the ACCC addressing the issues outlined in the notice, as per the terms of the notice, before the ACCC can make a decision in respect of the application.

In the event that the ACCC does not have sufficient information to approve or determine an operator's regulated water charges, the ACCC will have the ability to extend the time in which it is required to make its decision. The rules will allow the ACCC to extend the term of the decision-making period by three months provided it gives an explanation of the reasons why it has been unable to approve or determine the charges. The ACCC may extend its decision period a number of times provided it gives its reasons for this on each occasion.²⁶¹ While the ACCC's preference is to complete each approval or determination by 1 May of the following year (in time for the irrigation season) this might not be possible where an operator is not cooperating with the ACCC's requests for further information.

On receiving an operator's final pricing application, the ACCC will publish all non-confidential parts of the application and supporting documentation on its website. Interested parties will have an opportunity to provide comment on an application within a specified time period and the ACCC will take any non-confidential submissions received into account in arriving at a draft decision.

Before making a final decision on the application, the ACCC will issue a draft decision which either:

- proposes to approve some or all of the regulated charges set out in the application or
- proposes not to approve some or all the regulated charges set out in the application, specifies the reasons for this and provides a draft determination of the operator's regulated charges.

The ACCC's draft decision will include details of the basis and rationale for the proposed decision, including but not limited to:

- details of the qualitative and quantitative methodologies applied, including any calculations and formulae

²⁶¹ This was the intention in the draft advice although it was not made explicit. However, the draft rules that accompanied the draft advice did not provide for this. The draft rules provided with the advice now provide for the extension to be made multiple times.

- the values adopted for each of the input variables in any calculations and formulae, including a full description of the rationale for adopting those values
- details of other assumptions made in all material qualitative and quantitative analyses undertaken in assessing the proposed regulated charge against the pricing principles
- full reasons for all material judgments and qualitative decisions made and options considered, and all discretions exercised which have a material bearing on the outcome of the ACCC's overall decision.

The draft decision and any associated consultant reports that the ACCC has relied upon in reaching its draft decision will be published on the ACCC's website, subject to confidentiality. After this time, interested parties still have time to make submissions on the content of the draft decision or any supporting documentation (including consultant reports). This should address the concerns raised by the NFF in response to the position paper.

In relation to the due date for submissions, the ACCC will endeavour to ensure that interested parties receive adequate time in which to respond to the operator's pricing application and the ACCC's draft decision. In normal circumstances, the ACCC expects that interested parties will have at least eight weeks to provide submissions or comment.

At any stage throughout the process, the ACCC may undertake public hearings or roundtables. The ACCC understands that these processes are supported by stakeholders and these could form an important part of the approval or determination process.

Under normal circumstances, the ACCC will publish its final decision on a tier 3 operator's charges for a regulatory period by 1 May of the final year of the previous regulatory period. In response to concerns raised by the NFF in its submission to the position paper, this date should ensure that, in the absence of unforeseen circumstances, new prices are in place by 1 July in the year in which they are to apply.

In the event that the ACCC has not been able to approve or determine an operator's charges by the date that the current charges expire, the charges in force on the final day of the expiring regulatory period will remain in force for a period of six months or until the ACCC otherwise extends the decision period. However, where the ACCC makes an approval or determination within the six months or extended decision period, these charges would commence instead. If the ACCC has not been able to approve or determine charges in the six months or extended decision period, the operator will not be able to levy any regulated charges until such time as these have been approved or determined by the ACCC.

The ACCC notes State Water's concerns about an operator not being able to impose charges if those charges have not been approved or determined by the ACCC. However, the draft rules provide the ACCC with the scope to extend the decision period. In practice the ACCC is likely to extend the decision period unless the operator is being deliberately uncooperative with the ACCC. Hence, only where the operator is being deliberately uncooperative will they be in a position where they are unable to levy any fees or charges.

Rules relating to the price approval or determination processes undertaken before the commencement of a regulatory period are contained in Division 2 of Part 6 of the draft rules.

6.3 Annual variation of charges for the second, third and fourth years of a regulatory period

If charges are determined across a number of years and demand is variable and uncertain, there is a risk that the actual level of demand may differ significantly from the forecast level:

- Where demand is significantly less than anticipated, the operator may experience a revenue shortfall.
- Where demand is significantly greater than anticipated, customers may face prices higher than necessary (resulting in surplus revenue for the operator) or may be subject to demand rationing.²⁶²

Given the high variability in rainfall in Australia and the limited ability of operators to influence the supply of water, this is a key issue in the rural water sector.

To address revenue stability, the regulator could determine a revenue path for the duration of the regulatory period. In this way, prices would be adjusted to account for fluctuations in demand and there would be greater certainty about future levels of revenue.

However, this could result in annual price shocks, especially where demand is highly variable. Such price shocks are undesirable for customers as they require some price stability in order to make sound investment decisions. In balancing revenue stability against price stability, the ACCC is recommending a hybrid approach.

The annual variation process has been introduced to ensure that operators recover sufficient revenue in the presence of uncertain and highly variable rainfall. This section addresses specific aspects of the annual variation process—that being the approval or determination of charges for the second, third and fourth years of a regulatory period. In particular, this section covers:

- the pricing principles to be applied in approving or determining charges for the second, third and fourth years of a regulatory period
- the information required from operators before the start of the second, third and fourth years of a regulatory period
- the process for the annual variation of charges.

²⁶² Demand rationing may also be necessary under a revenue cap form of price control.

6.3.1 Pricing principles

In the draft advice, the pricing principles to be considered by the ACCC in approving or determining charges for the second, third and fourth years of a regulatory period were similar to those that were to be considered under the approval or determination process undertaken prior to the commencement of the regulatory period. Specifically, the ACCC was required to have regard to:

- the application made for the approval or determination undertaken prior to the commencement of the regulatory period
- the application made in respect of the year for which the charges are being approved or determined
- whether the proposed charges contributed to achieving the basin water charging objectives and principles
- whether the required revenue reflected prudent and efficient costs.

Views of interested parties

In response to the draft advice, State Water noted:

State Water is supportive of the ACCC's proposal to introduce annual revisions of consumption forecasts within the regulatory period. Such a move will assist State Water to fully recover its efficient costs despite increasingly unpredictable rainfall patterns ...

The ACCC's proposed methodology should reduce the risk of under and over recovering for the regulatory period and should improve financial viability. However, it will potentially lead to year on year fluctuations in prices between years. Such fluctuations will inevitably impact on customers and customer behaviour, including trading and the use of carryover. State Water recommends the ACCC investigate the potential impact of these changes in developing the guidelines for the annual adjustment. Under no circumstance should prices be changed mid-season, or retrospectively.²⁶³

Also in response to the draft advice, Gwydir Valley Irrigators Association Inc. (GVIA) stated:

GVIA has some concerns with the annual review of the charges for subsequent years as determined in the first year of the regulatory period ...

GVIA is concerned that if an operator can effectively ensure a set revenue each year, by matching prices to demand forecasts it effectively loads all climate related risk on the customer.²⁶⁴

ACCC's views

The intention of including an additional approval or determination process for charges in the second, third and fourth years of a regulatory period is to address revenue stability under uncertain demand or consumption.

²⁶³ State Water, op. cit., p. 2.

²⁶⁴ GVIA, op. cit., p. 3.

The ACCC was concerned that the draft rules that accompanied the draft advice did not sufficiently limit the matters that the ACCC will have regard to in approving or determining charges for subsequent years in a regulatory period. In particular, the ACCC should only be required to consider:

- the maximum charges (and estimated required revenue) determined as part of the approval or determination of charges before the commencement of the regulatory period
- the updated demand or consumption forecasts for the upcoming year
- whether those updated forecasts appear reasonable
- the proposed charges for the upcoming year.

In response to comments from interested parties, the ACCC also sees merit in including an additional criterion that requires the ACCC to have regard to price stability across years in approving or determining charges.

In summary, the ACCC will not approve an operator's proposed regulated charges for the second, third or fourth year of a regulatory period unless the ACCC is satisfied the regulated charges are those approved or determined under the approval or determination process that was undertaken prior to the commencement of the regulatory period for the relevant year, adjusted for any change in demand or consumption forecasts where the updated demand or consumption forecasts are reasonable. In approving or determining these charges the ACCC will also have regard to whether the proposed regulated charges will maintain price stability across years.

The criteria for approving or determining charges as part of the annual review process are contained in rule 37 of Division 3 of Part 6 of the draft rules.

6.3.2 Information required

The draft advice required tier 3 operators to submit updated demand or consumption data and updated proposed prices for the approval or determination of charges for the second, third and fourth years of a regulatory period.

Views of interested parties

None of the submissions received in response to the draft advice addressed the issue of what information is required from tier 3 operators under the annual variation process.

ACCC's views

The ACCC's position on information required for approvals or determinations for charges in the second, third and fourth years of a regulatory period has not changed since the draft advice. In particular, the tier 3 operators will be required to submit:

- information on their forecast demand or consumption for the upcoming year
- an estimate of demand or consumption for the year closing
- information on how the above items were calculated

- proposed prices for the upcoming year.

The information required from tier 3 operators as part of the annual review process is contained in rule 34 of Division 3 of Part 6 of the draft rules.

6.3.3 Process

Before the start of the second, third and fourth years of a regulatory period, tier 3 operators will be required to submit a pricing application to the ACCC. The ACCC will then prepare a draft decision and call for submissions. The ACCC will finally approve or determine the operator's charges within three months of receiving the application or within such time as has been extended.

Views of interested parties

None of the submissions received in response to the draft advice addressed the process for approvals or determinations in the second, third and fourth years of a regulatory period.

ACCC's views

The ACCC is not proposing any substantial changes to the annual variation process from that outlined in the draft advice. The proposed process is summarised below.

Five months before the end of the first, second and third years of a regulatory period, each tier 3 operator will be required to provide the ACCC with updated demand forecasts and its proposed charges for the following year to enable the ACCC to make a decision within the required time.

The ACCC will then be required to approve or determine the operator's proposed charges within three months of receiving an annual application from a tier 3 operator, provided the application includes sufficient information. The ACCC may write to the operator to request further information. The ACCC may also extend the period by which a decision is to be made by as much as one month, provided it gives reasons for this. This extension may be made numerous times.

As part of the annual adjustment process, the ACCC will invite submissions on its draft decision. It will also publish on its website all non-confidential parts of the operator's application, all non-confidential submissions received and the ACCC's final decision.

If an operator does not provide adequate information to allow the ACCC to approve or determine an operator's charges in respect of the annual review, the charges approved or determined for that year prior to the commencement of the regulatory period will be levied for a period of three months or, where the decision period is extended beyond three months, until the extended decision period expires. However, where the ACCC makes an approval or determination within the three months or extended decision period, these charges would commence immediately. After this time the operator will not be able to levy a charge unless it has been approved or determined by the ACCC as part of the annual approval process.

The process for the annual review of charges is outlined in Division 3 of Part 6 of the draft rules.

6.4 Commencement of the tier 3 rules

This section addresses when the ACCC should commence undertaking approvals or determinations.

As discussed above, the ACCC is recommending that large non-member owned operators should be subject to price approvals or determinations. In applying these criteria, the following operators would currently be captured:

- State Water
- GMW
- LMW.

As noted in the draft advice, the minister stated an intention to allow price paths in place at the time the water charge rules come into effect to run their course. For the above operators this means:

- until 30 June 2010 for State Water
- until 30 June 2013 for GMW and LMW.²⁶⁵

In addition, the ACCC recommended that for operators with determinations expiring in the 12 months following the commencement of the rules, the next determination will be undertaken using the arrangements in place the day before the rules commence. This transitional measure will only apply for one regulatory period, with the ACCC commencing approvals or determinations, as per the draft rules, at the expiry of that period.

In practice, this would mean that the ACCC would commence approvals or determinations for GMW and LMW for the period commencing 1 July 2013. As State Water's price paths expire within 12 months of the rules taking effect, IPART would be responsible for undertaking the following approval or determination under its existing arrangements. Following expiry of that regulatory period, the ACCC would assume responsibility for undertaking all following approvals or determinations for State Water under the water charge rules.

6.4.1 Views of interested parties

A number of submissions to the position paper discussed the commencement date for approvals or determinations.

State Water noted:

²⁶⁵ Senator Penny Wong, Minister for Climate Change and Water, media release, *Government provides certainty on rural water charges* (PW 2008/08), 2 October 2008.

... the proposed transition arrangements will result in the 2010 Determination being undertaken by IPART under the existing framework, with subsequent Determinations ... undertaken by the ACCC. State Water supports this approach, particularly because preparation for the 2010 Determination has already commenced.²⁶⁶

The NFF stated:

NFF supports the proposal for the transitional arrangements for existing price paths for Tier 3 operators.²⁶⁷

IPART made some recommendations in response to the proposed transitional arrangements:

[IPART believes that] the optimal transitional arrangement would be to accredit IPART to apply the Act and the new water charge rules to State Water's Basin activities for the next regulatory period ...²⁶⁸

IPART also suggested a prioritised implementation across operators:

IPART suggests that the ACCC should first determine prices for Tier 3 operators in those jurisdictions that are lagging behind best practice regulation and cost recovery. IPART should retain the responsibility of regulating State Water's Basin activities until the ACCC has progressed all other jurisdictions to the same level as NSW.²⁶⁹

In relation to existing price paths, the Queensland Farmers' Federation (QFF) noted:

The current irrigation price paths for SunWater schemes run until 30 June 2011 ... These price paths must be recognised to run for their remaining terms.²⁷⁰

No further comments were made in response to the draft advice.

6.4.2 ACCC assessment

In general, submissions to the position paper appeared supportive of existing price periods being allowed to remain in place until their expiry.

IPART, in its submission to the position paper, recommended that instead of undertaking the 2010 determination under its existing arrangements, it be accredited to undertake the determination under the water charge rules. The ACCC has recommended the above transitional arrangements in the understanding that State Water has already commenced preparations for the 2010 determination.²⁷¹

²⁶⁶ State Water, submission to the ACCC water charge rules position paper, November 2008, p. 3.

²⁶⁷ NFF, op. cit., p. 6.

²⁶⁸ IPART, loc. cit.

²⁶⁹ *ibid.*, p. 10.

²⁷⁰ QFF, submission to the ACCC water charge rules position paper, December 2008, p. 1.

²⁷¹ State Water, loc. cit.

If the ACCC were instead to recommend that the determination be undertaken under the water charge rules, this would not allow State Water (and potentially IPART) sufficient time to prepare for the determination to be completed by 2010. Hence, the ACCC recommends that IPART undertake the next determination (for State Water charges expiring in 2010) under its existing arrangements. The ACCC believes this is the best option for providing a smooth transition to the new arrangements as it will allow State Water to continue its preparations and will provide greater certainty to all parties involved in the 2010 determination.

IPART also suggested that the ACCC prioritise the commencement of approvals or determinations to concentrate on ‘jurisdictions that are lagging behind best practice’²⁷². As all operators that are being recommended for inclusion under tier 3 are already regulated by state-based economic regulators, the ACCC does not believe this argument is relevant.

Consistent with the draft advice, the ACCC is recommending the following:

- For operators that fall within tier 3 with determinations that expire more than 12 months after the rules take effect, the ACCC will commence approvals or determinations once these determinations have expired. This currently includes GMW and LMW for the period commencing 1 July 2013.²⁷³
- For those operators that fall within tier 3 whose current determinations expire within 12 months of the rules taking effect, the current state regulator will undertake the price determination for the next regulatory period under existing arrangements. On this basis, IPART will undertake State Water’s price determination for the period commencing 1 July 2010 under its existing arrangements.
- Following the expiry of this regulatory period, the ACCC will assume responsibility for undertaking all following approvals or determinations under the water charge rules. On this basis, the ACCC will assume responsibility following the expiry of State Water’s regulatory period beginning in 2010.²⁷⁴

As discussed in chapter 3, there will also need to be rules in place that set out the steps involved in transitioning new tier 3 operators—those that change their operations and consequently meet the tier 3 criteria—into a price approval or determination framework. This could occur if two non-member owned operators merge and the new operator holds (or services customers with) over 250 GL of water.

The ACCC will require 13 months to approve or determine an operator’s proposed charges. In order to ensure that new charges come into effect before the start of a new irrigation season, the ACCC recommends that operators moving into tier 3 provide a pricing application to the ACCC at least 15 months before the start of an irrigation season.

²⁷² IPART, loc. cit., p. 10.

²⁷³ Prior to this, these operators will still be subject to the tier 1 requirements (as soon as the tier 1 rules commence).

²⁷⁴ Prior to this, these operators will still be subject to the tier 1 requirements (as soon as the tier 1 rules commence).

Just as operators might move into tier 3, they could also move out of tier 3. For example, an operator might become smaller and hence fall out of tier 3. Where an operator is deemed no longer to be a tier 3 operator, any price approval or determination in place will continue until the end of the irrigation year (that is, the next occurring 30 June). This will ensure that there is some level of continuity for the operator and its customers. The operator would then be subject to its new level of regulation after the expiry of that year, subject to any transitional arrangements associated with the new level of regulation. However, in practice, it is unlikely that many operators will move in and out of tier 3 as a result of the size threshold.

6.5 Monitoring and enforcement

The Water Act requires the ACCC to monitor regulated water charges and compliance with the water charge rules and report to the minister on the results of such monitoring.²⁷⁵ This section discusses monitoring and enforcement provisions that are particular to the tier 3 rules. A more general discussion of the ACCC's approach to monitoring compliance and enforcing the water charge rules is provided in chapter 7.

In the draft advice, the ACCC proposed to collect information to enable it to monitor the performance of a regulated business during a regulatory period and provide a basis for assessing the expenditure and revenue forecasts used to approve water charges in subsequent regulatory periods. The ACCC proposed to develop information templates in consultation with stakeholders for this purpose.

6.5.1 Views of interested parties

None of the submissions to the position paper raised any specific issues in relation to the monitoring and enforcement of the tier 3 rules.

6.5.2 ACCC assessment

The ACCC proposes to request operators to provide the following information from their financial statements each financial year:

- operating expenditure by business segments and activity area
- capital expenditure by business segments, cost drivers and asset categories
- revenue by business segments and revenue sources.

The ACCC proposes to work with stakeholders to develop appropriate information templates before the start of the first regulatory period.

²⁷⁵ Section 94 of the Water Act.

7 Enforcement

This chapter discusses the ACCC's proposed approach to enforcement, monitoring and reporting on the water charge rules for water infrastructure fees and charges. The chapter discusses:

- the ACCC's approach to compliance and enforcement
- the ACCC's proposed approach to monitoring and investigating compliance
- which proposed rules should be designated as civil penalty provisions in accordance with s. 92(8) of the *Water Act (2007)* (Cwlth) (the Water Act)
- legal proceedings by persons suffering loss (s. 92(10))
- other remedies available under the Water Act regarding contraventions of the water charge rules.

7.1 ACCC approach

The Water Act provides for the ACCC to be the sole enforcement body for the water charge rules and water market rules.²⁷⁶ The primary outcomes that the ACCC seeks to achieve in undertaking its enforcement activities are to:

- ensure that the offending conduct ceases so that the damage occurring in the market is minimised
- prevent the offending conduct from recurring
- clarify interpretation of the Water Act, regulations, water charge rules and water market rules
- in appropriate circumstances, penalise offenders.

The ACCC has discretion in deciding whether to take enforcement action and the nature of any enforcement action. The ACCC will consider a number of factors when deciding whether to take enforcement action and which enforcement option to adopt. In general, the ACCC aims for a proportionate enforcement response taking into account the impact of the breach, the circumstances surrounding the breach and the operator's compliance programs and compliance culture.

In enforcing the water charge rules, the ACCC is operating under an expectation of full voluntary compliance with the law.²⁷⁷ It is anticipated that an operator will seek to

²⁷⁶ Section 137(b) of the Water Act.

²⁷⁷ The 'enforcement pyramid' model provides the theoretical underpinning of this approach, developed by Professors Ian Ayres and John Braithwaite and described in the Australian Law Reform Commission (ALRC) report: *Principled regulation: federal civil and administrative penalties in Australia* (ALRC 95) at 3.32 as 'an influential model to describe an ideal regulatory approach.' The model proposes that the regulator have access to severe punishments but should rarely use them in practice; it requires the ACCC to behave as though operators wish to cooperate and to ensure that it is economically rational for them to cooperate.

remedy any non-compliance or will have an adequate explanation or excuse for the allegation made against it.

7.2 Monitoring and investigating compliance

The ACCC has an obligation under s. 94 of the Water Act to monitor water charges and compliance with the water charge rules, and to give the minister a report on the results of this monitoring. In relation to this task, the ACCC is mindful of minimising operators' compliance costs where practical.

The ACCC has considered whether current reporting requirements on operators would yield sufficient information on the water charge rules to allow it to meet its requirements under s. 94. While some charging information is already publicly available, it is unlikely that this would be sufficient.

The proposed water charge rules should result in more information on water infrastructure fees and charges being made publicly available in a consistent and comparable form. The publishing requirements under the tier 1 rules, which are to apply to all operators, should provide a good base level of information on water charges. Further, provisions under the tier 2 and 3 rules will provide more detailed information which could be used to assess whether charges are contributing to achieving the Basin water charging objectives and principles.

In order to assist operators in complying with their information requirements and to minimise the associated compliance costs, the ACCC will develop information guidelines and templates in consultation with interested parties.

In addition to these formal information-gathering exercises, the ACCC is anticipating a cooperative response to information gathering by all parties. In the event of complaints about compliance with the charge rules, the ACCC has powers under s. 155 of the *Trade Practices Act 1974* to legally compel the provision of information on water matters and to require production of documents and/or attendance of key personnel at the ACCC's offices to answer questions.

7.3 Designation of civil penalty provisions

In deciding which rules should be designated as civil penalty provisions,²⁷⁸ the ACCC has considered which contraventions are likely to be most damaging to the achievement of the Basin water charging objectives and principles.²⁷⁹

²⁷⁸ Civil penalties are invoked by the state and are used in other corporate or regulatory contexts to regulate conduct. A civil penalty provision carries only a financial penalty, not an imprisonment penalty, and imposition of a civil penalty does not constitute a criminal conviction.

²⁷⁹ In deciding which rules to designate as civil penalty provisions, the ACCC also considered the principles and guidance provided in the *Guide to framing Commonwealth offences, civil penalties and enforcement powers*, issued by the Minister for Justice and Customs (2004), and the ALRC report: *Principled regulation: federal civil and administrative penalties in Australia* (ALRC 95) to ensure that Australian Government policy and the ALRC recommendations were considered in framing the civil penalty scheme in the water charge rules.

The ACCC has recommended civil penalties where:

- A member owned operator levies a different regulated charge for an infrastructure service of the same class provided in respect of an irrigation right or provided otherwise than in respect of an irrigation right and where that difference cannot be justified by the actual costs necessarily incurred in providing those infrastructure services.
- A member owned operator that services over 10 GL of entitlement and that pays a distribution to its members, imposes, demands or receives a regulated water charge that exceeds the charges that have been approved or determined by the ACCC.
- An infrastructure operator imposes, demands or receives a regulated water charge that has not been provided to customers in its schedule of fees and charges or that is not permitted under rule 13 of the market rules or rules 6 and 8 of the termination fees rules.
- A tier 2 operator has not developed a network service plan (NSP) and imposes, demands or receives a regulated water charge that does not relate to a charge detailed in the NSP or as amended in the information statement.
- A tier 3 operator imposes, demands or receives a regulated water charge that is in excess of that which has been approved or determined by the ACCC.

In the case of member owned operators, one of the main aims of the water charge rules is to ensure that there is no discriminatory charging behaviour against certain customers or customer types. Discriminatory charging could:

- deter transformation and trade
- distort trade
- result in operators moving away from user-pays charging.

The water charging objectives and principles include that the water charge rules should facilitate the efficient functioning of water markets, give effect to the principles of user-pays and avoid perverse or unintended outcomes.²⁸⁰ It is clear that if an operator is allowed to engage in discriminatory pricing practices, this will violate a number of the Basin water charging objectives and principles. This would constrain the extent to which the water charge rules could contribute to achieving these objectives and principles—the key aim of the rules. The ACCC considers that in order to achieve this aim, operators found to be charging member customers differently from non-member customers for the provision of what is essentially the same service (that is, where there is no difference in the actual costs necessarily incurred in providing the two services) should be subject to civil penalties.

Member owned operators could potentially circumvent the non-discriminatory charging rules through the payment of distributions to their member customers. The payment of distributions to member customers by a member owned operator would constitute a substantial change from current business practices under which these operators are effectively not-for-profit businesses. This would undermine many of the assumptions

²⁸⁰ Schedule 2, clauses 2(c), (d) and (e) of the Water Act.

underpinning the ACCC's proposals on the form of regulation for these operators. It would also limit the ability of the other rules to contribute to achieving the Basin water charging objectives and principles. For these reasons, the ACCC also considers that if member owned operators that provide services in relation to over 10 GL of entitlement²⁸¹ pay distributions, these operators should not be able to levy charges unless these have been approved or determined by the ACCC. Where these operators levy charges that have not been approved or determined by the ACCC, they should be subject to civil penalties.

The tier 1 publishing requirements are fundamental to achieving increased transparency around water charges and providing greater information to inform an efficient and dynamic water market. For this reason, operators that do not comply with the tier 1 publishing requirements will be subject to civil penalties.

An essential part of the tier 2 rules is to provide greater transparency around the processes followed in determining expenditure requirements for the infrastructure network and in setting charges. In particular, the tier 2 rules will leverage existing arrangements to further contribute to achieving the Basin water charging objectives and principles. In order to do this it is essential that tier 2 operators develop a network service plan. This key document will ensure that operators have been sufficiently rigorous in determining expenditure priorities and resulting charges and that customers are informed of these processes and decisions. If a tier 2 operator does not develop an NSP, this will undermine the ability of the tier 2 rules to contribute to achieving the Basin water charging principles and objectives. For this reason, the ACCC believes that operators that do not develop an NSP prior to introducing new fees and charges should be subject to civil penalties.

If a tier 3 operator levies charges that have not been approved or determined by the ACCC, there is no way to ensure that those charges are efficient and will result in efficient water use and trade. Further, such charges could send distorted signals to users of water infrastructure and this could result in the inefficient use or investment in such infrastructure. Therefore, if tier 3 operators do not comply with the tier 3 requirements, this could substantially limit the ability of the rules to contribute to achieving the Basin water charging objectives and principles. For this reason, the ACCC recommends that tier 3 operators that levy charges that are not less than or equal to those approved or determined by the ACCC should be subject to civil penalties.

Where a water charge rule has been designated as a 'civil penalty provision',²⁸² the court may order a person to pay a pecuniary penalty for a contravention.²⁸³ A pecuniary penalty is a sum of money. In the case of the water charge rules, the maximum sum that

²⁸¹ Available under water access entitlements.

²⁸² Rules designated as civil penalty provisions are clearly identifiable by the inclusion of the words 'civil penalty' and an amount in penalty units set out at the foot of the provision.

²⁸³ In determining the amount of the penalty, the court must consider all relevant matters, including the nature and extent of the contravention, the nature and extent of any loss or damage suffered as a result of the contravention, the circumstances in which the contravention took place and whether the person has previously been found by the court in proceedings under the Water Act to have engaged in any similar conduct—see s. 147(4) of the Water Act.

can be ordered is 200 penalty units (currently \$22 000) for individuals and five times that amount otherwise. This means that operators that are corporations²⁸⁴ may be liable for maximum pecuniary penalties of up to 1000 penalty units (currently \$110 000) per contravention.²⁸⁵

7.4 Legal proceedings by persons suffering loss or damage

While the ACCC will actively encourage those with concerns about the conduct of a particular operator to liaise with the ACCC at an early stage, the ACCC believes that the right to take legal action should be independent of whether the ACCC takes enforcement action. The draft rules provide that a person who suffers loss or damage as a result of a contravention of the rules by an operator may bring legal proceedings to recover the amount of the loss or damage by action against that other person or against any person involved in the contravention.

7.5 Other remedies

The ACCC has a number of remedies available to it under Part 8 of the Water Act:

- infringement notices
- enforceable undertakings
- injunctions and declarations.²⁸⁶

Infringement notices can only be applied for rules with civil penalty provisions. All other remedies—enforceable undertakings, injunctions and declarations—can be used for the enforcement of any water charge rules.

In addition, criminal proceedings may be brought by the Commonwealth in certain circumstances against a person or operator that provides false or misleading information to the ACCC.

7.5.1 Infringement notices

Infringement notices can be issued where an authorised ACCC officer has reasonable grounds to believe there has been a contravention of a civil penalty provision.²⁸⁷ The

²⁸⁴ Including ‘irrigation corporations’ as listed in Schedule 1 of the *Water Management Act 2000* (NSW)—currently Coleambally Irrigation Cooperative Limited, Jemalong Irrigation Limited, Western Murray Irrigation, Murray Irrigation Limited and Murrumbidgee Irrigation Limited.

²⁸⁵ This higher penalty for corporations is consistent with the ‘corporate multiplier’ in s. 4B(3) of the *Crimes Act 1914* (Cwlth), and with the approach recommended by the *Guide to framing Commonwealth offences, civil penalties and enforcement powers*, issued by the Minister for Justice and Customs (2004, p. 37).

²⁸⁶ The remedies discussed are available against natural persons and bodies corporate. See Part 8, Division 9 of the Water Act.

²⁸⁷ Part 8, Division 5 of the Water Act.

recipient will have the choice to pay a reduced pecuniary penalty to the ACCC within 28 days or risk legal proceedings in relation to the contravention.²⁸⁸ The choice to pay the penalty is not taken as an admission of liability for the alleged contravention and any liability of the person for that contravention is then discharged.

7.5.2 Enforceable undertakings

Enforceable undertakings are negotiated agreements between the ACCC and the operator (for example, to achieve certain compliance goals within a particular timeframe and/or to not commit further offences).²⁸⁹ The offering of an enforceable undertaking is voluntary and cannot be compelled by the ACCC.

The ACCC may apply to the court for enforcement of an enforceable undertaking. The court can make several types of orders, including that the operator pay the ACCC an amount equivalent to any financial benefit the operator has obtained in relation to the breach or pay compensation to any other person who has suffered loss or damage as a result of the breach.

7.5.3 Injunctions and declarations

Injunctions²⁹⁰ and declarations²⁹¹ are also available under Part 8 of the Water Act. Injunctions are court orders that can:

- restrain or require particular conduct
- require implementation of a specified program for compliance with the rules
- require disclosure of information to correct or counter the effect of a contravention of the rules
- require the publishing of an advertisement to correct or counter the effect of a contravention of the rules.

Declarations are formal statements by the court, creating or preserving a legal right. Once a declaration is made, the ability of aggrieved third parties to take legal action under the Water Act is enhanced.

In general, court-ordered remedies are more likely to be sought in serious cases where other remedies are insufficient.²⁹² Court proceedings may also be appropriate where there is a genuine question of legal interpretation that the ACCC would like to see

²⁸⁸ Equal to one-fifth of the maximum penalty the court could impose in relation to that contravention. That is, a maximum of 40 penalty units (currently \$4400) for individuals and 200 penalty units (currently \$22 000) otherwise.

²⁸⁹ Part 8, Division 6 of the Water Act.

²⁹⁰ Part 8, Division 2 of the Water Act.

²⁹¹ Part 8, Division 3 of the Water Act.

²⁹² These include seeking full civil pecuniary penalties, injunctions, declarations, enforcement of infringement notices and enforcement of enforceable undertakings. Note: non-compliance with any court orders may be a 'contempt of court'. Further enforcement is a matter for the court and can include imprisonment.

settled (that is, a ‘test case’) because taking a matter to court provides a public judicial opinion on interpretation of the rules.

7.5.4 Providing false or misleading information to the ACCC

A person who knowingly gives false or misleading information to the ACCC or omits any matter without which the information is misleading may be guilty of an offence under s. 137.1(1) of the Criminal Code 1995. Section 137.2 of the Criminal Code makes similar provision for false or misleading documents, where such documents are produced in compliance or purported compliance with a law of the Commonwealth. The maximum penalty for these offences is imprisonment for 12 months and/or a fine of \$6600.²⁹³

²⁹³ See ss. 4B(2) and 4AA(1) of the Crimes Act.

Appendix 1 Statistics of larger MDB operators

Operator	Ownership	Entitlement (GL)
State Water ^a	non-member	8430.0
Goulburn-Murray Water (GMW) ^b	non-member	1804.6
Murray Irrigation Limited ^c	member	1615.7
Murrumbidgee Irrigation Limited ^c	member	1426.3
Coleambally Irrigation Cooperative Limited ^c	member	647.4
Lower Murray Water (LMW) ^d	non-member	440.0
Central Irrigation Trust (CIT) ^e	member	159.6
SunWater ^f	non-member	138.6
Jemalong Irrigation Limited ^c	member	100.0
West Corugan Private Irrigation District ^g	member	85.9
Grampians Wimmera Mallee Water ^h	non-member	75.6
The Narromine Irrigation Board of Management ^g	member	64.7
Trangie Nevertire Irrigation Scheme ^g	member	63.4
Western Murray Irrigation Limited ^c	member	61.3
Renmark Irrigation Trust ⁱ	member	50.7
Moir Private Irrigation District ^g	member	39.8
Tenandra Scheme ^g	member	38.2
Buddah Lake Irrigators ^g	member	35.0
Abercrombie Pumping Association ^g	member	33.9
Eagle Creek Pumping Syndicate ^g	member	17.2
Coliban Water ^j	non-member	14.7
SA Water ^k	non-member	13.5
Hay Private Irrigation District ^g	member	13.4

- a State Water's Request for information (RFI) response to the ACCC indicated that the volume of entitlements held by its customers in 2007–08 was 8430 GL.
- b GMW, *Water Plan 2008*, October 2007, p. 63.
- c Data on entitlement and customers: National Water Commission, *Australian Water Markets Report 2007–08*, December 2008, p. 15. Data on irrigation entitlement volumes: NSW Government, ACCC RFI response, August 2008.
- d Lower Murray Water, *2007–08 Annual Report*, 2008, p. 2.
- e CIT, *Annual Report 2007–08*, 2008. CIT incorporates the Berri, Cadell, Chaffey, Cobdogla, Kingston, Loxton, Moorook, Myponga and Waikerie Irrigation Trusts Inc.
- f SunWater, ACCC RFI response, February 2009. Data is for SunWater's MDB operations only.
- g NSW Government, ACCC RFI response, August 2008.
- h Grampian Wimmera Mallee Water, *Water Plan 2008–13 Updated*, February 2008, p. 21. Figures do not include groundwater and bore services.
- i SA Department of Water, Land and Biodiversity Conservation, *pers comm.*, 15 December 2008.
- j Coliban Water Annual Report 2008, p. 25.
- k SA Government, ACCC RFI response, August 2008.

Appendix 2 List of submissions

List of submissions relating to the irrigation infrastructure operators issues paper:

- DW Sehestedt
- Narromine Irrigation Board of Management
- Southern Riverina Irrigators and Ricegrowers Association of Australia
- NSW Murray Wetlands Working Group
- South Australian Murray Irrigators
- Bourke Shire Council
- NSW Irrigators' Council
- Central Irrigation Trust
- Macquarie River Food and Fibre
- Bogan Shire Council
- EO Wittle
- Goulburn-Murray Water
- Coleambally Irrigation Cooperative Limited
- SunWater
- The Bondi Group
- Minerals Council of Australia
- Murrumbidgee Irrigation Limited
- Murray Irrigation Limited
- NSW Farmers' Association
- National Water Commission
- Peter Leslie and Doug Ferguson
- Tom Loffler (customer of Central Irrigation Trust)
- Callandoon Water Board
- Western Murray Irrigation
- Department of Natural Resources and Water (Qld)
- Victorian Farmers' Association
- National Farmers' Federation
- Department of Sustainability and Environment
- Department of Water, Land and Biodiversity Conservation

List of submissions relating to the bulk water issues paper:

- Victorian Farmers' Federation
- Geoff Allan
- State Water (with attachments)
- Southern Riverina Irrigation and Ricegrowers Association of Australian
- Goulburn-Murray Water
- Murray Irrigation Limited
- NSW Irrigators' Council
- Queensland Farmers' Federation (with attachments)
- Bondi Group
- National Farmers' Federation
- Western Murray Irrigation Limited
- Peel Valley Water Users Association Inc.
- New South Wales Independent Pricing and Regulatory Tribunal
- Department of Natural Resources and Water (Qld)

List of submissions to the water infrastructure charge rules position paper:

- Central Irrigation Trust
- New South Wales Independent Pricing and Regulatory Tribunal
- Mark Cameron
- Macquarie River Food and Fibre
- Murrumbidgee Horticulture Council Inc.
- Murrumbidgee Irrigation Limited
- NSW Irrigators' Council
- Rodney Van De Hoef
- State Water
- SunWater
- Western Murray Irrigation
- The Hon. Craig Wallace MP
- National Farmers' Federation
- Queensland Farmers' Federation
- Queensland Government
- Victorian Government

List of submissions to the water infrastructure charge rules draft advice:

- Lower Murray Water
- Macquarie River Food and Fibre
- NSW Irrigators' Council
- Government of South Australia
- Gwydir Valley Irrigators Association Inc.
- State Water
- SunWater
- Western Murray Irrigation Limited
- Victorian Government
- Queensland Farmers' Federation
- Murrumbidgee Irrigation Limited

Appendix 3 Basin water charging objectives and principles

Water charging objectives

The *water charging objectives* are:

- (a) to promote the economically efficient and sustainable use of:
 - (i) water resources
 - (ii) water infrastructure assets
 - (iii) government resources devoted to the management of water resources
- (b) to ensure sufficient revenue streams to allow efficient delivery of the required services
- (c) to facilitate the efficient functioning of water markets (including inter-jurisdictional water markets, and in both rural and urban settings)
- (d) to give effect to the principles of user-pays and achieve pricing transparency in respect of water storage and delivery in irrigation systems and cost recovery for water planning and management
- (e) to avoid perverse or unintended pricing outcomes.

Water charging principles

Water storage and delivery principles

- (1) Pricing policies for water storage and delivery in rural systems are to be developed to facilitate efficient water use and trade in water entitlements.
- (2) Water charges are to include a consumption-based component.
- (3) Water charges are to be based on full cost recovery for water services to ensure business viability and avoid monopoly rents, including recovery of environmental externalities where feasible and practical.
- (4) Water charges in the rural water sector are to continue to move towards upper bound pricing where practicable
- (5) In subclause (4):
upper bound pricing means the level at which, to avoid monopoly rents, a water business should not recover more than:

- (a) the operational, maintenance and administrative costs, externalities, taxes or tax equivalent regimes
 - (b) provision for the cost of asset consumption
 - (c) provision for the cost of capital (calculated using a weighted average cost of capital).
- (6) If full cost recovery is unlikely to be achieved and a community service obligation is deemed necessary:
- (a) the size of the subsidy is to be reported publicly
 - (b) where practicable, subsidies or community service obligations are to be reduced or eliminated.
- (7) Pricing policies should ensure consistency across sectors and jurisdictions where entitlements are able to be traded.

Cost recovery for planning and management

See ACCC Water Planning and Management Position Paper

Environmental Externalities

- (1) Market-based mechanisms (such as pricing to account for positive and negative environmental externalities associated with water use) are to be pursued where feasible.
- (2) The cost of environmental externalities is to be included in water charges where found to be feasible.

Benchmarking and efficiency reviews

- (1) Independent and public benchmarking or efficiency reviews of pricing and service quality relevant to regulated water charges is or are to be undertaken based on a nationally consistent framework.
- (2) The costs of operating these benchmark and efficiency review systems are to be met through recovery of regulated water charges

Appendix 4 Current arrangements

Governance and regulatory arrangements for bulk water operators

Bulk water operators are responsible for the harvesting and storage of water and for its transportation and delivery to customers, which include town water authorities, mines and industry, as well as irrigation infrastructure operators.

Bulk water services in Australia have historically been provided by state governments to ensure that an adequate level of service is provided. More recently, the corporate structure of many bulk water businesses has changed; however, the majority remain state government owned.

SunWater, a Queensland Government owned corporation, provides direct water supply services to irrigators, mines, power generators and local governments across Queensland (within and outside of the MDB). In this way, it is a vertically integrated water business. Within the MDB, SunWater's systems predominantly consist of water storages and rivers; the only constructed channels are within the St George scheme. Therefore, most of SunWater's activities within the MDB are bulk water activities.

State Water Corporation (State Water), a New South Wales Government owned corporation, undertakes bulk water supply functions in rural New South Wales (within and outside of the MDB). Its customers include irrigation infrastructure operators, town water supply authorities, farms, mines, electricity generators and stock and domestic customers. It is also responsible for delivering environmental flows on regulated rivers.

Goulburn-Murray Water (GMW), a Victorian Government owned statutory authority, provides water harvesting, storage and delivery services in central north Victoria²⁹⁴ (wholly within the MDB). It is a vertically integrated water business that provides services to irrigators, urban and rural water supply authorities and hydroelectric power companies.

Grampians Wimmera Mallee Water (GWMWater), also a Victorian Government owned statutory authority, undertakes rural and urban water supply services in north western Victoria²⁹⁵ (wholly within the MDB). It is a vertically integrated water business that services urban water users, industrial customers, domestic and stock customers, irrigators and town water supply authorities.

River Murray Water (RMW) is an internal business division of the Murray–Darling Basin Authority established to operate and manage the River Murray system. RMW's

²⁹⁴ Its area of operations is bordered by the Great Dividing Range in the south, the River Murray in the north, Corryong in the east and Nyah in the west.

²⁹⁵ Its area of operations extends from the Grampians in the south, Wedderburn up to Swan Hill (where it borders the River Murray) in the east, Chinkapook in the north and Gorokey in the west.

main function is to decide when to allow releases from storages along the River Murray and lower Darling. State Water, GMW and South Australian Water Corporation (SA Water) then undertake bulk water supply functions at the request of RMW (and receive funding from RMW).

SA Water, a Government of South Australia owned statutory corporation, delivers rural and urban water and wastewater services across South Australia (within and outside of the MDB). SA Water receives the majority of its water from the River Murray and stores and distributes this water (mixed with supplementary water) for urban and rural uses. SA Water provides bulk water services under agreement with Barossa Infrastructure Limited, as well as peak and off-peak water transportation agreements with individual irrigators.

Each of the MDB jurisdictions has different arrangements for the economic regulation of bulk water service providers.

In New South Wales, the Independent Pricing and Regulatory Tribunal (IPART) regulates the charges that State Water may levy for delivering bulk water. In effect, IPART sets the maximum charges that State Water may levy. State Water cannot levy charges that are higher than these maximum charges and can only levy lower charges if it attains the approval of the New South Wales Treasurer.²⁹⁶

In Victoria, each rural water business is required to prepare a water plan outlining what services it intends to provide, how it intends to fulfil its legal, environmental and community obligations and its proposed prices (based on estimates of its required revenue) for the regulatory period. This is a requirement for each rural water business under its respective statement of obligations. The water plan is then submitted to the Essential Services Commission (ESC) for approval. If the ESC is not satisfied with the arrangements proposed in a water plan, it may specify the prices that a business may charge or the manner in which those prices are to be calculated or otherwise determined.

In Queensland, SunWater sets its own price paths in line with the Queensland Government's high level rural water pricing policy and any pricing direction notices issued under the *Water Act 2000* (Qld). SunWater sets these charges through a two-staged negotiation and communication process involving SunWater customers and industry representatives. If referred by the Queensland Premier or Treasurer, the Queensland Competition Authority (QCA) may recommend or determine prices charged by a Queensland water business. However, the QCA has not yet had any formal role in regulating SunWater's charges.

In South Australia, SA Water's charges are determined by Cabinet (through the South Australian Treasury). The Essential Services Commission of South Australia (ESCOSA) does not have any powers to approve or determine charges but does review the processes and principles underpinning the charges. This review, called a transparency statement, assesses the processes followed and principles used by the Government of South Australia (including whether the Council of Australian

²⁹⁶ Section 18 of the *Independent Pricing and Regulatory Tribunal Act 1992* (NSW).

Governments' pricing principles were applied). ESCOSA can also have a role in undertaking inquiries into water or wastewater pricing issues as directed by the South Australian Treasurer. Four such inquiries have been completed.

Charging arrangements of bulk water operators

Bulk Water charges generally reflect a two-tariff structure to ensure the recovery of both fixed and variable costs of the service provider. The forward-looking incremental cost of an additional unit of consumption is reflected in the volumetric (variable) charge and a share of the fixed or sunk costs is reflected in the fixed charge.

The costs associated with the provision of bulk water services are largely fixed, being associated with the provision of storage and delivery capacity (fixed costs) as opposed to the use of that capacity which occurs when water is physically delivered (variable costs).

Bulk water service providers often segment costs according to geographical boundaries that represent various catchments or water supply districts. Within the interconnected system or district, the costs associated with the storage and delivery of water are recovered from the customers within that district. The fixed and volumetric charges are often levied on a uniform or postage stamp basis for the district. However, the level of entitlement security is also used to allocate fixed charges.²⁹⁷

SunWater's charges recover costs from harvesting and storage through to delivery. Charges are in the form of a two-part tariff and vary by valley. State Water's charges are levied as a two-part tariff and vary according to the security of the entitlement and by valley.

GMW charges for its bulk water services in two ways:

- All customers that do not hold an unbundled water access entitlement pay a 'bulk water charge' that varies by valley (for example, urban and rural water supply authorities and hydroelectric power companies pay this charge).
- Irrigators holding an unbundled water access entitlement pay an 'entitlement storage fee' through which GMW recovers the costs of providing the bulk water service.

Both types of charges vary by valley.

GWMWater levies rural bulk water charges in three valleys (these vary by valley). There do not appear to be any charges or fees levied to separately recover the costs of providing rural bulk water services to irrigators. However, this could be because water access entitlements in the area serviced by GWMWater are still bundled with delivery, making separate charging more difficult.

²⁹⁷ A characteristic of water entitlements is the level of security attached to them. For example, in New South Wales High Security entitlements have a 95 per cent security (an expectation that water is delivered in 95 years out of every 100) while for General Security entitlements the security is 50 per cent.

RMW is funded by the Australian, New South Wales, Victorian and South Australian governments and does not levy any charges on water users.²⁹⁸

Governance and regulatory arrangements for irrigation infrastructure operators

Considerable diversity exists in the number, size and ownership arrangements of irrigation infrastructure operators across the Basin. Irrigation networks have been privatised in both New South Wales²⁹⁹ and South Australia,³⁰⁰ but in Victoria and Queensland³⁰¹ the majority of water service infrastructure, including irrigation networks, remains with a small number of government owned authorities. Operators in the Basin have varying corporate governance arrangements; arrangements in Victoria and Queensland are substantially different from arrangements in New South Wales and South Australia. The types of arrangements with customers also vary within jurisdictions.

In New South Wales, all operators are privately owned and the majority of the larger operators are non-listed, not-for-profit companies. Many of the operators have a cooperative structure—the member/irrigators are in effect the shareholders in the entity that owns the shared irrigation network.

Similarly, in South Australia the operators are typically private trusts where the irrigators are the members.

In Victoria, five government owned statutory authorities³⁰² provide access services within the Victorian region of the Basin.³⁰³ Victorian operators must submit their corporate plans each year to the responsible minister to ensure compatibility of their business directions with government policy. One operator, GMW, is a vertically integrated operator providing bulk water services to other operators as well as to its own downstream operations and industrial and urban customers.³⁰⁴ Lower Murray Water (LMW) is a horizontally integrated operator providing both rural and urban water services.³⁰⁵

²⁹⁸ State Water recovers the user share of the New South Wales government contribution to the RMW's costs (incorporating an efficiency adjustment) through its charges. This is predominantly recovered from the Murray Valley but a small amount is also recovered from the southern basin and the total basin. This amount is then passed back to the New South Wales government (IPART, *Bulk water prices for State Water Corporation and Water Administration Ministerial Corporation from 1 October 2006 to 30 June 2010*, September 2006).

²⁹⁹ Not including assets used for the purpose of providing bulk water, which are under the ownership and control of State Water, a government owned bulk water supplier.

³⁰⁰ The exception is the South Australian Water Corporation (SA Water).

³⁰¹ SunWater provides irrigation delivery services to the majority of Queensland irrigators within the Basin.

³⁰² Coliban Water, GMW, LMW, FMIT and GWMWater.

³⁰³ Victorian Government, response to ACCC request for information, 18 February 2008, p. 7.

³⁰⁴ Victorian Government, response to ACCC request for information, 18 February 2008, p. 5.

³⁰⁵ LMW, response to ACCC request for information, February 2008, p. 6.

SunWater, which provides access services to almost all Queensland irrigators in the Basin,³⁰⁶ has recently changed its structure from a statutory government owned corporation to a company government owned corporation. However, under both arrangements, it is accountable to its shareholding ministers. SunWater organises its access services and fees on the basis of local schemes. The delivery of water is supported by contracts with the water storage operator and the infrastructure operator respectively. The delivery contract with the infrastructure operator (generally SunWater) defines the service standards and delivery conditions as well as the rights and payment obligations of the holder.

In Victoria, an independent economic regulator, the ESC, is responsible for making determinations about prices and service standards. The ESC's process is designed to ensure that operators earn a sustainable revenue stream and monopoly rents are avoided. Any community service obligations imposed by government to achieve wider social or environmental policy objectives are transparently reported by the ESC. Where the funding of these obligations is provided by government, the associated expenditure is excluded from the charging base of operators.³⁰⁷

SunWater determines prices for its water supply schemes in consultation with its customers through a three-tiered negotiation process. SunWater reports regularly to the Queensland Government and, if negotiations fail, the government may intervene to set the level for prices.³⁰⁸

In New South Wales and South Australia, no substantive government or independent regulatory oversight exists for operators that are privately owned. It is worth noting that for the privately owned operators in New South Wales and South Australia, the nexus between service provider and customer may reduce the incentive to maximise monopoly profits as lower water delivery costs may actually benefit the members' own downstream irrigation operations.

Charging arrangements of irrigation infrastructure operators

An irrigation infrastructure operator typically provides two main services to its customers: to make available capacity of its irrigation network for the delivery of water to be used in irrigation and to make available capacity of its irrigation network for the drainage of water previously used in irrigation (access services).

Fees associated with the provision and use of access services generally consist of two components: a volumetric fee and a fixed fee. The two components or 'parts' to this

³⁰⁶ Two exceptions are the small local operations of Yambocully and Callandoon water boards.

³⁰⁷ In its *Regional and rural businesses water plans 2008–13*, draft decision, the ESC has stated that 'the value of the contribution should be netted off the regulatory asset base to ensure the business does not recover the costs through prices', p. 76.

³⁰⁸ Queensland Government, response to ACCC request for information, 19 February 2008, p. 5.

charging structure reflect the two cost components faced by operators: fixed and variable costs.

Fixed costs can be associated with the provision of access services (or making capacity available), including the capital financing costs associated with the renewal of the irrigation network. A number of methods exist for allocating fixed costs across network users. The most common is the number or volume of entitlements held, but other options include allocations per hectare, per property, per connection and per service point. Fixed costs may also vary between districts, reflecting differences in geography, hydrology and the physical characteristics of infrastructure.

Variable costs can be associated with the physical delivery of water (or the use of capacity), including pumping and other costs that vary with the volume of water delivered. For access services, variable costs are generally lower than fixed costs.

The MDB Agreement now requires that water delivery rights be unbundled from any water access right and be recognised through a separate, explicit delivery entitlement by a date no later than 30 June 2010.³⁰⁹ The holder of a delivery entitlement should be able to choose whether to surrender the delivery entitlement and pay the relevant termination fee or continue to hold the delivery entitlement and pay the annual access fee.³¹⁰ This has the effect of promoting the trade of water to more highly valued uses and creates tradeable entitlements to irrigation network capacity, where the market price for such a product can be useful in signalling capacity constraints within the irrigation network.

The states are at different stages in giving effect to this agreement. In Victoria, explicit delivery entitlements (or delivery shares) that specify a flow rate and delivery time have been in effect since 1 July 2007.³¹¹ South Australia has enacted legislative provisions³¹² to separately recognise delivery entitlements.

In New South Wales, while some operators have created explicit delivery entitlements to comply with the access, exit and termination fee protocol, others either have not or have instituted a practice of requiring the one-for-one termination of delivery entitlements when the corresponding water access right is transferred out of the operator's irrigation district.³¹³

³⁰⁹ See clauses 6(1) and 6(2) of the access, exit and termination fee protocol.

³¹⁰ See clause 11(3) of the access, exit and termination fee protocol.

³¹¹ Minister's directions on water entitlements made under s. 228 of the *Water Act 1989* (Vic), made on 20 June 2006 and coming into force on 1 July 2007.

³¹² Part 3, Division 5 of *Natural Resources Management (Water Resources and Other Matters) Amendment Act 2004* (SA).

³¹³ MIL, *Murray Irrigation Limited water and delivery entitlements structure, transfer rules policy and charges policy*, April 2008.

In Queensland,³¹⁴ the delivery of water is supported by contracts with the water storage operator and the infrastructure operator respectively. The delivery contract with the infrastructure operator (generally SunWater) defines certain conditions, including a fee for terminating the delivery contract. It appears that delivery contracts entered into in Queensland are issued and managed separately from the irrigator's water access right.³¹⁵

³¹⁴ The access, exit and termination fee protocol applies to the upper River Murray and the River Murray in South Australia and to regulated reaches of the Goulburn, Campaspe, Loddon and Murrumbidgee systems.

³¹⁵ Water access entitlements are termed water allocations in Queensland.