Australian
Competition &
Consumer
Commission

GPO Box 520
Melbourne Vic 3001

Level 35, The Tower
360 Elizabeth Street
Melbourne Vic 3000

tel: (03) 9290 1800
fax: (03) 9663 3699

www.accc.gov.au

Our ref: 48904
Contact officer: Shane Grosser
Contact phone: (03) 9290 1846

9 July 2012

Review of Rural Water Charging Systems
Independent Pricing and Regulatory Tribunal
PO Box Q290
QVB POST OFFICE NSW 1230

Dear Sir/Madam

Re: Submission to the IPART Review of Rural Water Charging Systems Discussion Paper

Thank you for the opportunity to provide a submission to IPART's June 2012 discussion paper for its review of rural water charging arrangements in New South Wales (NSW).

The ACCC welcomes IPART's review and considers that it is an important process for clarifying a number of relevant policy issues for State Water Corporation (State Water) and the NSW Government in the lead up to the ACCC's forthcoming review of State Water's bulk water prices.

The Water Charge (Infrastructure) Rules 2010 (WCIR) provide that the ACCC will have responsibility for approving or determining the regulated charges of State Water to apply from 1 July 2014[1]. The WCIR in conjunction with:

i) the *Pricing principles for price approvals and determinations under the Water Charge (Infrastructure) Rules July 2011* (Pricing Principles); and

ii) the ACCC publication *A guide to the Water Charge (Infrastructure) Rules: Pricing application for Part 6 operators October 2011*[2]

set out the regulatory requirements of, and ACCC's views on, the pricing approval/determination process under the WCIR and relevant information requirements for price applications. For ease of reference Attachment 1 replicates the sections of the Pricing Principles that are relevant to IPART's discussion paper.

[1] The ACCC has been advised by the NSW Government that it does not intend to seek for IPART to become accredited under part 9 of the WCIR.

[2] See www.accc.gov.au/water.

The ACCC understands that IPART's recommendations following its review, and subsequent decisions by the NSW Government, will be key inputs into State Water's pricing application to the ACCC.

The ACCC is particularly interested to see confirmation of the NSW Government's approach to cost shares prior to receiving a pricing application from State Water.

In coming to a decision on State Water's prices from 1 July 2014, the ACCC will consider State Water's pricing application on its merits, the views of stakeholders and any other relevant information available at that time, in accordance with the WCIR. Stakeholders will have opportunities to comment on State Water's pricing application and the ACCC's draft decision prior to the ACCC making a final decision.

Once again, thank you for the opportunity to provide a submission to IPART's review process.

Yours sincerely

Sebastian Roberts
General Manager
Water Branch

Attachment 1 – Extracts from *Pricing principles for price approvals and determinations under the Water Charge (Infrastructure) Rules July 2011*

3.9 Cost allocation principles

Cost allocation refers to the allocation of an operator's various costs to each of its various services and consequently, to the charges it levies for those services. In general, costs will be directly attributable or shared. That is, some costs will only arise due to a particular service being provided (direct costs) while other costs will be incurred in providing a number of services (shared costs). While the allocation of direct costs is relatively straightforward, the allocation of shared costs can be more difficult.

Initially, operators will need to identify which costs are associated with providing infrastructure services, as opposed to other costs borne by the operator (i.e. their regulated costs/services as opposed to their unregulated costs/services). The costs associated with providing infrastructure services will be the costs to which a regulated charge applies.

Those costs that are associated with providing infrastructure services to which a regulated charge applies will then need to be allocated as either direct or shared costs.

In the case of direct costs, only costs that are directly attributable to the provision of a particular category of service may be directly attributed to that category of service. The operator will have some discretion in determining the level to which it identifies direct costs; these could be to the customer level, to the category of service level or to the irrigation district level, for example. Generally, the level of cost identification and allocation should align with the level to which charges are determined. For example, if charges are levied by valley, direct costs should be identified and allocated at the valley level.

Shared costs incurred in providing several categories of service must be allocated between those categories. Where there is an identifiable relationship between the shared costs and the services being provided, a causal allocator should be used to share those costs between services. For example, if costs increase with the number of megalitres delivered, the causal allocator could be the number of megalitres delivered. Where shared costs are immaterial or a causal relationship cannot be established without undue cost and effort, the operator may use a non-causal allocator to allocate costs between services.

A Part 6 operator's methodology for allocating costs to different services must be sufficiently detailed so that the regulator could replicate the operator's methodology. In particular, the operator should include in its Part 6 application information:

- For directly attributable costs:
  - the nature of each cost item
  - the category of service to which the cost item is to be directly attributed

· the characteristics of the cost item that associate it uniquely with a particular category of service in order to make it a directly attributable cost.

· For shared costs that are allocated between services using a causal allocator:

· the nature of each cost item

· the categories of service to which the cost items are being attributed

· the nature of the causal allocator(s) being used to allocate costs

· the reasons for selecting the allocator(s) and an explanation of why it is the most appropriate allocator for the cost item

· details of the numeric quantity or percentage of the allocator(s) including how these have been determined

· whether the numeric quantity or percentage of the allocator(s) is likely to remain constant over time.

· For shared costs that are allocated between services using a non-causal allocator:

· the basis of allocation

· the reason for that basis

· an explanation of why the shared cost is immaterial or why no causal relationship could be established without undue cost and effort

· the numeric quantity or percentage of the non-causal allocator applied to each category of service and in total.

In allocating costs between various categories of services, the same cost is not to be allocated more than once. Namely:

· the same cost may not be treated as both a direct cost and a shared cost

· a direct cost may only be attributed once to a single category of service

· the allocation of a shared cost must not exceed more than 100 per cent

of the cost.

An operator is not locked into using particular types of charges and tariff structures (see section 3.11). However, transparency around how costs are allocated between different activities will assist the regulator in assessing:

· the efficiency and prudency of the cost base of the operator

· the extent to which the proposed charges and tariff structures recover the underlying costs of providing infrastructure services.

3.11 Tariff structures

Given the multitude of supply scenarios across the Basin, it is neither practical nor desirable to prescribe particular tariff structures for different types of infrastructure services. Nevertheless, in approving or determining regulated charges, the regulator must have regard to the Basin water charging objectives and principles.

For example, charges must promote the economically efficient use of water infrastructure assets. In practice, this can be best achieved where the fixed and variable components of a charge recover the fixed and variable costs of providing services.

Charges must also be sufficient to ensure that the required infrastructure services continue to be efficiently delivered. That is, charges must be designed so that businesses earn a sufficient revenue stream in order to meet their regulatory, legal and other obligations.

It will also be important that customers can readily understand the tariffs they are likely to face and the amount they would pay under different scenarios. Therefore charges should be clear to customers and promote pricing transparency.

6.1 User shares—treatment of government contributions

As noted in chapter 2, Part 6 applies in respect of regulated charges levied by Part 6 operators. As such, a regulator operating under Part 6 of the rules may only approve or determine regulated charges as defined under the rules and the Water Act.

In approving or determining an operator's charges under Part 6 of the WCIR the regulator will be required to assess whether the operator's costs associated with providing infrastructure services are prudent and efficient. The regulator will then use these efficient costs to determine the operator's total revenue requirement. Any revenue received outside of charges (for example, from government or customer contributions or from asset sales) will then be subtracted from the total required revenue to determine the amount of revenue that charges need to recover. This will be used to determine regulated charges.

In this way, while the costs associated with an activity that is not funded through regulated charges will be assessed for prudency and efficiency, the source or amount of that funding will not be determined by the regulator. The regulator can only determine regulated charges.

Hence, any government (or other) contribution to a Part 6 operator's costs will be taken as an independent input to the price approval or determination process. This includes any share of costs relating to certain activities, full or part funding of certain infrastructure projects or assets, or lump sum contributions from government.

To the extent that a government is contributing to a Part 6 operator's costs this is independent of the Part 6 price approval or determination process. A government contribution is a government policy decision, rather than being determined by a regulator under the WCIR.

6.3 Other mechanisms for managing revenue volatility

The WCIR and pricing principles provides regulators with flexibility on a range of different mechanisms that can be used to address potential revenue volatility. Measures available to a regulator include:

- choosing the form of price control (see section 3.10)
- setting tariff structures (see section 3.11)

· changing charges during a regulatory period to reflect changes in forecast demand or consumption (see section 2.2).

However, in some circumstances a regulator may wish to introduce other mechanisms to manage likely revenue volatility over the regulatory period. For instance, a regulator could estimate the opportunity costs associated with bearing the risk of revenue volatility over the period, or could estimate the likely cost of purchasing insurance to manage revenue volatility.

Any other mechanisms can also be applied by a regulator on a case by case basis, subject to meeting the requirements in the rules. This must include an assessment of whether the approach would contribute to achieving the Basin water charging objectives and principles under Schedule 2 of the Water Act.