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**Procedure and terms for establishing a price for water service
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The Decree is established on the basis of § 16 (9) and (10) of the “Public Water Supply and Sewerage Act”.

Chapter 1. General provisions

§ 1. Scope of application and objective

(1) The Decree regulates the procedure and terms and conditions for establishing a temporary price for water service to a water undertaking located on a wastewater collection area, the pollution load of which is 2000 population equivalent or more (hereinafter *water undertaking*) by the Competition Authority.

(2) The aim of the Decree is to ensure a justified price for water service for the consumers also in case the water undertaking is providing the water service with a price that does not comply with the terms set out in § 14 (2) of the “Public Water Supply and Sewerage Act”.

§ 2. Definitions

(1) Definitions used in the Decree have the following meaning:

- 1) **Temporary price** – a temporary sales price for water service to be established to the water undertaking by the Competition Authority on the basis of § 16 (9) and (10) of the “Public Water Supply and Sewerage Act” and this Decree;
- 2) **Accounting period** – financial year preceding the year when the Competition Authority issued a prescription that the water undertaking did not comply with;
- 3) **Investments into regulatory asset base** – nonrecurring costs for acquiring and improving regulated fixed assets;

- 4) **Weighted average cost capital (WACC)** – the cost of total capital calculated on the basis of the capital structure (the ratio between own and external funds in the total capital) and the cost of debt and the cost of equity;
- 5) **Capital expenditure** – the expenses related to the acquisition of fixed assets, which are included in the temporary price;
- 6) **Rate of depreciation** – the reciprocal of the time period that shows inclusion of the expenses incurred in the acquisition of fixed assets in the prices for good and services to be sold to consumers. The rate of depreciations is determined by the useful life of the fixed asset;
- 7) **Allowed sales revenue** – justified sales revenue for water service, which is calculated by the Competition Authority in the proceeding of establishing a temporary price for water service and in the calculation of which the allowed sales revenue the costs regarded as justified by the Competition Authority, the capital expenditure and justified return shall be taken into account;
- 8) **Justified return** – operating profit that is calculated as the product of the value of regulated asset base and the justified rate of return;
- 9) **Justified rate of return** – rate of return from regulatory asset base that does not exceed the weighted average capital cost (WACC) of the undertaking;
- 10) **Regulated activity** – economic activity of the undertaking regarding which the regulator applies the regulation;
- 11) **Regulatory asset base** – fixed assets and working capital used in the regulatory activity;
- 12) **Operating expenses** – justified costs to be included in the price, which do not include capital cost and financial cost;

Chapter 2. Procedure of establishing a temporary price

§ 3. Preconditions for and notice of establishing the temporary price

(1) The Competition Authority shall decide on establishing the temporary price in case of the simultaneous occurrence of the following preconditions:

- 1) water undertaking is providing the water service with a price that does not comply with the terms set out in § 14 (2) of the “Public Water Supply and Sewerage Act”;
- 2) water undertaking has failed to comply with the prescription of the Competition Authority for bringing the applied price into compliance with the law.

(2) The Competition Authority shall issue a notice of establishing the temporary price to the water undertaking, when issuing a prescription. The notice of establishing temporary prices shall contain at least the following information:

- 1) Name of the addressee and postal address;
- 2) Reference to the prescription, the non-compliance with which resulted in establishing a temporary price;
- 3) Expected term of the proceeding of establishing the temporary price;
- 4) Signature of the person that issued the notice;
- 5) Date of the notice.

(3) Notice may accompany the prescription or may be issued as a separate note. The notice may be submitted with the notice of applying the coercive measures as set out in Substitutive Enforcement and Penalty Payment Act.

§ 4. Proceeding of establishing a temporary price

(1) Competition Authority is entitled to initiate a proceeding of establishing a temporary price (hereinafter *the proceeding*) immediately after finding out that the water undertaking has not complied with the prescription by the time fixed.

(2) For initiating the proceeding the Competition Authority shall submit to the water undertaking a notice regarding initiating the proceeding. The notice includes the reason and basis for initiating the proceeding and explains which information the Competition Authority requires from the water undertaking for conducting the proceeding.

(3) Water undertaking has a right to provide its written position to the notice stipulated in section 2 of this paragraph by the term set by the Competition Authority in the notice and to make a reasoned proposal for conducting consultations. Water undertaking is obliged to submit to the Competition Authority all the required information or to enable access thereto by the term established by the Competition Authority.

(4) Competition Authority is entitled to not start consultations with the water undertaking in case the proposal referred to in Clause 3 of this Section is unjustified or according to the Competition Authority the reasons submitted by the water undertaking for starting the consultations are not appropriate. Competition Authority shall submit the reasons for refusing to start consultations to the water undertaking in writing.

(5) When consultations are commenced, the Competition Authority has a right, after it has heard the position of the water undertaking, to terminate the consultations at any time when the water undertaking does not provide the data or explanations required by the Competition Authority or if the Competition Authority has reached a reasoned position regarding establishing the temporary price or not establishing the price.

§ 5. Term of the temporary price procedure and asking for opinion

(1) The Competition Authority shall determine the temporary within 30 days from the water undertaking has submitted the required information for establishing the temporary price or from the termination of the consultations referred to in § 4(3) of this decree. If there are good reasons, the Director General of the Competition Authority has a right to extend with his order the term up to 60 days, and inform the water undertaking thereof before the original term expires.

(2) Before establishing a temporary price the Competition Authority shall submit the calculation of the temporary price to the water undertaking for submitting its opinion and objections, by setting a reasonable term for the water undertaking for submitting its opinion and objections.

(3) Before establishing the temporary price the Competition Authority asks for an opinion regarding the temporary price calculated by the Competition Authority from the rural

municipality or city government regarding the compliance of the temporary price with the public water supply and sewerage development plan. In case the rural municipality or city government does not submit its opinion regarding the temporary price within 30 days as of the receipt of the respective inquiry by the Competition Authority, then it is regarded that the rural municipality or city government does not have any objections to the temporary price calculated by the Competition Authority.

§ 6. Terminating the proceeding and applying a temporary price

(1) The Director General of the Competition Authority shall formalise the decision on establishing a temporary price with its decree within 30 days as of the receipt of the opinion and objections of the water undertaking or as of the term set for submitting the opinion and objections and the receipt of the opinion regarding the calculation of the temporary price from rural municipality or city government or as of the expiry of the term set out in § 5 (3) of this Decree.

(2) If it becomes evident in the course of the proceeding that the price applied by the water undertaking is justified and in compliance with the terms set out in § 14 (2) of the “Public Water Supply and Sewerage Act” or the water undertaking complies with the prescription and starts to apply a price for water service that is in compliance with the terms set out in § 14 (2) of the “Public Water Supply and Sewerage Act” before the temporary price is established by the Competition Authority, the Director General of the Competition Authority shall terminate the proceeding with its decree.

(3) The decision on establishing a temporary price, also the decree of terminating the proceeding, shall be delivered to the water undertaking immediately, but no later than within three working days as of signing the decree.

(4) The water undertaking is obligated to apply the temporary price as of the delivery of the decision on establishing a price, unless the decision on establishing a temporary price itself does not provide a later term for taking effect.

(5) The Competition Authority shall publish the decision on establishing a price with the reasons on its website, omitting from the text business secrets of the water undertaking.

Chapter 3. Conditions of establishing a temporary price

§ 7 Main terms of establishing a temporary price

(1) When establishing a temporary price, the existing price structure of the water undertaking and the division of fees as indicated in § 14 (1) of the “Public Water Supply and Sewerage Act” shall be considered.

(2) a temporary price shall be designed so as to accord with the conditions set out in § 14 (2) of the “Public Water Supply and Sewerage Act”.

(3) Volume of water shall be taken as the basis for calculating the price for discharge and treatment of wastewater, storm water and drainage water discharged from the immovables and other soil and surface water. Volume of wastewater, storm water, drainage water and other soil or surface water to be discharged to public sewerage system shall be calculated or measured pursuant to the rules of use of public water supply and sewerage system.

(4) If the water undertaking provides a water service in several different wastewater collection areas servicing more than 2000 human equivalents or more, a common temporary price for water service may be established for all areas, taking into account the summary costs of the water undertaking.

(5) The following justified costs shall be taken into account when establishing a temporary price:

- 1) operating costs;
- 2) capital costs;
- 3) justified rate of return.

(6) When establishing a temporary price the consumption volumes and allowed sales revenue of the accounting period shall be taken into account.

(7) The following cost items shall not be included in the temporary price:

1. Costs for bad debts;
2. Sponsorship, gifts and donations;
3. Fees paid to the mediators of water service;
4. Costs not related to core activity;
5. Penalties and fines for delay imposed to the undertaking on the basis of laws;
6. Financial costs;
7. Undertaking's income tax cost (e.g. cost for income tax paid on dividends);
8. Other costs of the water undertaking that have proved to be unjustified during the economic analysis undertaken by the Competition Authority.

(4) In case the water undertaking has not followed the principles of efficient management and cost-savings, due to which the costs of the accounting period of the water undertaking are not justified, the Competition Authority may use, amongst other things, the following methods to calculate justified costs of the water undertaking:

- 1) Observing the dynamics of costs in time and the comparison thereof with the dynamics of the CPI;
- 2) In-depth analysis of the justifiability of various cost components (incl. expert opinions);

3) Comparison of the operating expenses of the undertaking and the statistical indicators calculated on the basis thereof with the indicators of other undertakings.

(9) In case the water undertaking has not carried out the obligations resulting from the law with regard to the differentiation of expenses, the Competition Authority may request the differentiation of expenses from the water undertaking and in case of disregarding the request may proceed from the data and information that have been found out.

§ 8. Capital expenditure and regulatory asset base

(1) The aim of the capital expenditure is to recover the expenses made for the acquisition of fixed assets through the price for the water service during the useful life of the fixed assets.

(2) When calculating capital expenditure the regulatory assets shall be used as base. Capital expenditure is calculated from the depreciable fixed assets included within the regulatory asset base

(3) The following shall not be included into the regulatory asset base:

1) Fixed assets not used in core activity;

2) Long-term financial investments;

3) Intangible fixed assets (except for computer software and programmes' licences and connection fees paid to other water undertakings);

4) Fixed assets acquired through state aid (e.g. EU aid programmes);

5) Fixed assets acquired from the connection fees paid by the consumers;

6) Unjustified investments.

(4) Regulatory asset base shall include connection fees paid to other water undertakings.

(5) When calculating the value of regulatory asset base, the residual book value at the end of the accounting period is used. In the calculation of the capital expenditure, depreciation rate on regulatory assets base reflected in the accounting shall be used.

(6) The RAB at the accounting period is calculated as follows:

$$\mathbf{RAB = RAB_r + WC}$$

Where

RAB – regulated asset base;

RAB_r – residual book value of RAB in the end of a regulation period;

WC – working capital.

(7) 5% of the allowed sales revenue of the accounting period shall be taken as the basis for calculating the working capital.

(8) The internal turnover of companies belonging to a vertically integrated group is not included in the calculation of working capital.

(9) If after 31.12.2009 revaluations of fixed assets reflected in the accounting of the undertaking have been performed and/or the depreciation rates of fixed assets have been changed considerably or if the depreciation rates of the fixed assets do not comply with the useful lifetime thereof, then RAB and capital expenditure shall be calculated as follows:

- 1) As from 31.12.2009 (hereinafter the margin year) the fixed assets of the water undertaking are divided into old (fixed assets acquired before the margin year) assets and new (fixed assets acquired since the margin year) assets.
- 2) In the calculation of capital expenditure, separate accounts shall be kept for the assets acquired before and after the margin year, and thus also a separate account of the capital expenditure shall be kept.
- 3) In the calculation of capital expenditure the linear capital expenditure calculation method is applied.
- 4) There is a right to make adjustments to the cost of fixed assets and capital expenditure rates in case it becomes evident that the fixed assets acquired either before or after the margin year include assets that the undertaking is not actually employing for carrying out its economic activity or in case it becomes evident that the capital expenditure rates are not justified.
- 5) Capital expenditure on fixed assets acquired before the margin year shall be reported at its residual value. Thereby capital expenditure rate(s) shall be established for fixed assets acquired before the margin year, based on which the calculation of capital expenditures to be included in the prices shall take place.
- 6) Capital expenditure on fixed assets acquired after the margin year shall be reported at its acquisition value. Thereby capital expenditure rate(s) shall be established for the fixed assets acquired after the margin year, based on which the calculation of capital expenditures to be included in the prices shall take place.
- 7) If necessary, the differentiation of assets may be used, by using different capital expenditure rates.

8) Capital expenditure to be included in the temporary price for water services is calculated as follows:

$$A_{prices} = A_{before\ m.y} + A_{after\ m.y}$$

Where:

A_{prices} – capital expenditure to be included to the prices;

$A_{before\ m.y}$ – capital expenditure on fixed assets acquired before the margin year;

$A_{after\ m.y}$ – capital expenditure on fixed assets acquired after the margin year.

9) Capital expenditure is calculated from fixed assets acquired before the margin year as follows:

$$A_{before\ m.y} = N-CA\ residual\ v_{before\ m.y} \times rate_{before\ m.y}$$

Where:

$N-CA\ residual\ v_{before\ m.y}$ – fixed assets at residual value acquired before margin year;

$rate_{before\ m.y}$ – capital expenditure rate established for fixed assets acquired before margin year.

10) Capital expenditure is calculated from fixed assets acquired after the margin year as follows:

$$A_{after\ m.y} = (N-CA\ acquisition\ c_{after\ m.y} + 0,5 \times I) \times rate_{after\ m.y}$$

Where:

$NCA\ residual\ v_{after\ m.y}$ – fixed assets at acquisition cost acquired after margin year;

I – investments made into the regulated fixed assets during the regulation period;

$Rate_{after\ m.y}$ – capital expenditure rate established for fixed assets acquired after margin year.

11) Calculation of RAB:

$$RAB = (RAB_0 + RAB_1)/2 + WC,$$

Where:

RAB – Regulated asset base;

RAB_0 – residual book value of RAB in the beginning of a regulation period;

RAB_1 – residual book value of RAB in the end of a regulation period;

WC – working capital

12) The value of RAB in the end of a regulation period is calculated as follows:

$$RAB_1 = RAB_0 + I - A - M,$$

Where

RAB_0 - residual book value of RAB in the beginning of regulation period;

RAB₁ – residual book value of RAB in the end of regulation period;

I – investments made into RAB;

A – capital expenditure;

M – fixed assets sold or written off.

§ 9. Justified return

(1) Justified return is calculated on the basis of applying a justified rate of return on RAB.

(2) Justified return is calculated based on the following formula:

$$\mathbf{JR = r_j \times RAB,}$$

Where

JR - Justified return;

R_j - allowed rate of return (WACC);

RAB - regulatory asset base

(1) Justified rate of return equals with WACC:

$$\mathbf{R_j = WACC,}$$

Where

WACC – weighted average cost of capital.

(2) WACC is calculated based on the following formula:

$$\mathbf{WACC = C_{equity} \times \left(\frac{E}{D + E} \right) + C_{debt} \times \left(\frac{D}{D + E} \right)}$$

Where

C_{equity} - cost of equity (%)

C_{debt} - cost of debt (%)

D - proportion of debt (%)

E - proportion of equity (%).

(5) In the calculation of WACC a capital structure of 50% debt and 50% equity is used.

(6) When determining the cost of debt, the interest levels of a long-term periodic money market (the average of 5 last years of German 10 year bonds), country risk and company risk are taken as the basis. In case state bonds exist, the cost of debt may be determined on the basis of the interest rate of a state bond.

(7) The cost of equity is calculated according to the CAPM (*capital assets pricing model*) model as follows:

$$C_{\text{equity}} = R_f + R_c + \beta \times R_m,$$

Where

C_{equity} - cost of equity

R_f - risk-free rate of return

R_c - country risk premium

β - beta coefficient

R_m - market risk premium.

(8) Risk-free rate of return is regarded as the 5-year average interest rate of a German 10-year bond, to which the country risk premium is added. In case state bonds exist, the interest rate of state bonds may be regarded as the risk-free rate of return.

(9) Beta coefficient is determined on the basis of the respective indicator of other European and/or US regulated companies.

(10) The market risk premium is determined on the basis of long-term market risk premiums of other European and/or US regulated companies.

§ 10. Calculation of the allowed sales revenue and temporary price

(1) allowed sales revenue is calculated on the basis of the following formula:

$$R_{\text{allowed}} = OE + CE + JR,$$

Where

R_{allowed} - allowed sales revenue;

OE - Operating expenses;

CE - Capital expenditure;

IR - Justified return.

(2) The allowed sales revenue is divided between various water services on the basis of the proportion of the turnover of various water services received during the accounting period (price

for water services as defined in § 14 (1) of the Public Water Supply and Sewerage Act) in the turnover of the total water service provided in such a manner that the following formula applies:

$$R_{\text{allowed}} = \Sigma R_{\text{allowed}_n}$$

Where

R_{allowed_n} – allowed sales revenue of the respective service;

(3) Allowed sales revenues of the respective water service serves as the basis for establishing the price, proceeding from the following formula:

$$\text{price}_n = R_{\text{allowed}_n} / m_n \text{ [e.g. kr/m}^3\text{; kr/month]}$$

Where

m_n - sales volume of the respective water service during the accounting period;

price_n - temporary price for the respective water service established by the Competition Authority.

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