



**Tasmanian Water and Sewerage Industry**

**2018 Price Determination Investigation**

**Draft Price and Service Plan Guideline**

**May 2016**

Printed May 2016  
Office of the Tasmanian Economic Regulator  
Level 5, 111 Macquarie Street, Hobart TAS 7000  
GPO Box 770, Hobart TAS 7001  
Phone: (03) 6166 4422

ISBN 978-0-7246-5411-6

Copyright  
© Office of the Tasmanian Economic Regulator

# TABLE OF CONTENTS

<b>ACRONYMS &amp; GLOSSARY .....</b>	<b>III</b>
<b>1 INTRODUCTION .....</b>	<b>1</b>
1.1 INDUSTRY REGULATION .....	1
<b>2 REGULATORY APPROACH .....</b>	<b>3</b>
2.1 REGULATORY PRIORITIES AND CONSIDERATIONS .....	3
2.2 PRICING PRINCIPLES .....	4
2.3 PRICE DETERMINATION .....	5
2.4 APPROACH TO ASSESSMENTS OF ASSET VALUES AND COSTS .....	5
2.5 DATA COLLECTION TEMPLATE AND FINANCIAL MODEL .....	6
2.6 CONSULTATION BY THE REGULATOR .....	7
2.7 INVESTIGATION PROCESS TIMETABLE .....	7
<b>3 CUSTOMER AND STAKEHOLDER CONSULTATION .....</b>	<b>8</b>
3.1 INFORMATION REQUIRED IN THE PROPOSED PRICE AND SERVICE PLAN .....	8
<b>4 CUSTOMER SERVICE STANDARDS .....</b>	<b>10</b>
4.1 APPROACH TO DEVELOPING REVISED SERVICE STANDARDS .....	10
4.2 REGULATOR'S APPROACH TO ASSESSING SERVICE STANDARDS .....	10
4.3 INFORMATION REQUIRED IN THE PROPOSED PRICE AND SERVICE PLAN .....	11
<b>5 OPERATING EXPENDITURE .....</b>	<b>12</b>
5.1 REPORTING OPERATING EXPENDITURE .....	12
5.2 INFORMATION REQUIRED IN THE PROPOSED PRICE AND SERVICE PLAN .....	12
<b>6 CAPITAL EXPENDITURE .....</b>	<b>14</b>
6.1 REPORTING CAPITAL EXPENDITURE .....	14
6.2 INFORMATION REQUIRED IN THE PROPOSED PRICE AND SERVICE PLAN .....	15

<b>7</b>	<b>REVENUE REQUIREMENT .....</b>	<b>16</b>
7.1	STATUTORY REVENUE LIMIT .....	16
7.2	REGULATED ASSET BASE .....	17
7.3	RATE OF RETURN.....	21
7.4	TREATMENT OF ASSETS USED TO PROVIDE UNREGULATED SERVICES .....	23
7.5	INFORMATION REQUIRED IN THE PROPOSED PRICE AND SERVICE PLAN.....	24
<b>8</b>	<b>TARIFF LEVELS AND STRUCTURES .....</b>	<b>25</b>
8.1	PRICING ZONES .....	26
8.2	CUSTOMER CLASSES .....	26
8.3	WATER CHARGES .....	27
8.4	SEWERAGE CHARGES.....	27
8.5	INFORMATION REQUIRED IN THE PROPOSED PRICE AND SERVICE PLAN.....	27
<b>9</b>	<b>PRICE REGULATION .....</b>	<b>28</b>
9.1	INFORMATION REQUIRED IN THE PROPOSED PRICE AND SERVICE PLAN.....	29
<b>10</b>	<b>CUSTOMER CONTRACT AND POLICIES.....</b>	<b>30</b>
10.1	INFORMATION REQUIRED IN THE PROPOSED PRICE AND SERVICE PLAN.....	30
10.2	SERVICE REPLACEMENT PROPOSALS .....	31
<b>11</b>	<b>DEMAND FORECASTS.....</b>	<b>32</b>
11.1	INFORMATION REQUIRED IN THE PROPOSED PRICE AND SERVICE PLAN.....	32
<b>12</b>	<b>REGULATORY COMPLIANCE .....</b>	<b>35</b>
12.1	APPROACH TO REVIEWING COMPLIANCE .....	35
12.2	INFORMATION REQUIRED IN THE PROPOSED PRICE AND SERVICE PLAN.....	36

## ACRONYMS & GLOSSARY

<b>Term</b>	<b>Meaning within the context of this Guideline</b>
Accounting ring fencing	The separation of a regulated entity's accounts for the purpose of economic regulation, including splitting between regulated and unregulated components
Capex	Capital expenditure ie investment in new regulated assets
CPI	Consumer Price Index
Developer charges	Includes headworks charges; assets gifted by developers; and cash payments made by developers to a regulated entity for the construction of new reticulation works
DORC	Depreciated Optimised Replacement Cost
DPIPWE	Department of Primary Industries, Parks, Water and Environment
EPA	Environment Protection Authority
Industry Act	<i>Water and Sewerage Industry Act 2008</i>
Opex	Operating and maintenance expenditure related to the day to day operations of TasWater
RAB	Regulated Asset Base
Regulator	The Tasmanian Economic Regulator established under the <i>Economic Regulator Act 2009</i>
TasWater	Tasmanian Water and Sewerage Corporation Pty Ltd
Target tariffs	A price structure that applies in the region serviced by a regulated entity and used to reform tariffs in accordance with proposed price constraints
Tariffs	Prices charged by a regulated entity for the provision of regulated services made up of fixed charges, variable charges and miscellaneous charges
Transition period	The period from 1 July 2012 to 1 July 2020 inclusive (prescribed in Regulation 32 of the Pricing Regulations)
WACC	Weighted average cost of capital



# 1 INTRODUCTION

This Guideline, issued in accordance with sections 65(7) and 65(8) of the *Water and Sewerage Industry Act 2008* (Industry Act) is designed to assist TasWater in preparing, and the Regulator in approving, TasWater's proposed price and service plan for the third regulatory period.

The purpose of this Guideline is to set out the Regulator's minimum requirements for the information that should be provided in TasWater's proposed price and service plan for the regulatory period commencing on 1 July 2018. It also provides information on how the price determination investigation will be conducted (including consultation) and specifies the actions TasWater must take in preparing its proposed price and service plan.

TasWater's proposed price and service plan must provide sufficient information for the Regulator to assess and determine prices, revenues, terms and conditions, for water and sewerage services. TasWater is required to clearly articulate and commit to a set of outcomes and prices to be delivered over the regulatory period.

The Regulator expects TasWater to consult with customers and stakeholders during the development of its proposal.

## 1.1 Industry regulation

The Tasmanian water and sewerage industry has undergone a period of significant change over the past decade. From 1 July 2013, the formation of a single regulated entity, the Tasmanian Water and Sewerage Corporation Pty Ltd (TasWater), signalled the final stage in the reform process that began in 2008.

The Industry Act is the primary legislative instrument governing the economic regulation of the Tasmanian water and sewerage industry. The following regulations impact on the economic regulation of the industry in general and the price determination investigation in particular:

- *Water and Sewerage Industry (Pricing and Related Matters) Regulations 2011* (the Pricing Regulations); and
- *Water and Sewerage Industry (Customer Service Standards) Regulations 2009* (the Customer Service Standards Regulations).

The Regulator is responsible for the regulation of prices, terms and conditions for water and sewerage services. Independent regulation of water and sewerage prices in Tasmania commenced on 1 July 2012.

Economic regulation of the industry is focussed on both price and service outcomes. At a high level, the Industry Act requires price and service plans to address three key elements:

- regulated water and sewerage services, and standards of service, to be delivered to customers over a regulatory period;
- revenues to deliver the regulated services to the agreed standards, based on efficient service delivery costs; and
- regulated prices (or tariffs) that meet the pricing principles under the Industry Act and Pricing Regulations.

The minimum service standard framework is set out in the *Tasmanian Water and Sewerage Industry Customer Service Code* (the Code).<sup>1</sup> A regulated entity is required to comply with the Code.

---

<sup>1</sup> Issued by the Regulator in July 2010, Version 4 effective 1 July 2015.

## 2 REGULATORY APPROACH

In making a price determination under the Industry Act, the Regulator must adopt an approach and methodology which it considers will best meet the objective of the Industry Act which is:

to protect the long-term interests of customers and to provide for the safe, environmentally responsible, efficient and sustainable provision of reliable and secure water services and sewerage services to the Tasmanian community.

### 2.1 Regulatory priorities and considerations

The Regulator acknowledges that the transition to an equitable pricing structure will be largely completed by the end of the second regulatory period. Therefore, for the third regulatory period, the Regulator intends adopting an approach that reflects the following priorities:

- funding compliance investment in line with regulatory expectations
- ensuring sufficient revenue for the efficient delivery of the required services
- continuing to manage the impact of price changes on customers

The overarching efficiency objective of the Industry Act will be given priority to resolve any conflicts between pricing objectives and principles.

Given these potentially competing objectives, there will be some trade-offs between priorities. Priority will be given to achieving the pricing principles and ensuring TasWater's revenue requirements are met.

The Regulator will assess TasWater's proposed costs in providing water and sewerage services to customers together with the prices it intends charging over the regulatory period for the services it proposes.

In approving TasWater's proposed price and service plan the Regulator must be satisfied that it will have sufficient revenue to meet its obligations and deliver the agreed standards of customer service while taking into account the impact of price changes on customers. The Regulator may require TasWater to amend its plan if it is not satisfied that the proposed price and service plan meets the requirements specified in this Guideline or the relevant Price Determination.

The Regulator is also required to ensure that any tariff reforms are consistent with the pricing principles under the Industry Act, or represent a transition towards achieving those principles.

## 2.2 Pricing principles

The Regulator must determine prices in accordance with the pricing principles contained in the Industry Act together with any additional pricing principles in the Pricing Regulations. The Industry Act specifies a transition period for the application of the pricing principles from 1 July 2012 to 1 July 2020 (inclusive).

### 2.2.1 Pricing principles in the Industry Act

According to the pricing principles outlined in section 68 of the Industry Act, the price for the provision of a regulated service must:

- give a regulated entity reasonable opportunity to recover the efficient costs it incurs in providing those services or complying with its regulatory obligations;
- provide for efficient two-part, cost-reflective pricing;
- provide effective incentives to promote economic efficiency, reduce costs, or otherwise improve productivity;
- allow a regulated entity to receive a return on assets used in providing the regulated service; and
- to the extent that it is commercially and technically reasonable, reflect the costs that are directly attributable to a particular customer or class of customers.

### 2.2.2 Pricing Regulations

The Pricing Regulations contain additional pricing principles in relation to the following matters:

- pricing zones (nodal pricing);
- the structure of service introduction charges;
- the calculation of developer charges;
- the treatment of contributed assets<sup>2</sup>; and
- the basis for setting fixed and variable charges (including the prohibition of free water allowances).

The Regulator must also account for the impact of the rate of change of prices for customers.

---

<sup>2</sup> Contributed assets include developer charges and government grants but exclude equity contributions from the owner of a regulated entity. Furthermore, the assets of the three previous regulated entities which have been and will be vested in TasWater are not to be treated as capital contributions.

### **2.2.3 Pricing transition period**

Section 68AA of the Industry Act enables the pricing principles not to be applied to the formation or approval of price and service plans and price determinations during the transition period to the extent that the application of those principles would:

- result in a significant impact on customers, or a particular class of customers, due to the rate of change in prices;
- adversely affect the sustainability of a regulated entity in so far as it provides regulated services; or
- adversely affect the ability of a regulated entity to deliver regulated services.

TasWater's proposed price and service plan must satisfy all of the pricing principles in the Industry Act and the Pricing Regulations, except where it can justify why it is unable to satisfy any individual pricing principles, in the context of the requirements of section 68AA.

## **2.3 Price determination**

The Regulator will use the building block methodology to calculate revenue limits. As distinct from the Regulator's first and second price determination investigations, the statutory revenue limit is likely to determine prices for TasWater's water and sewerage customers with the exception of those customers transitioning to target tariffs.

The third price determination investigation for the Tasmanian water and sewerage industry will involve three steps:

1. confirming the service outcomes that TasWater proposes to deliver over the third regulatory period, including service standards and regulatory compliance;
2. assessing the revenue required to meet the service obligations and expected outcomes identified in Step 1; and
3. approving an appropriate tariff structure that:
  - meets the requirements of the pricing principles;
  - generates TasWater's revenue requirement considering demand forecasts; and
  - manages the impact of the rate of change of prices on customers.

## **2.4 Approach to assessments of asset values and costs**

In price regulation the main determinant of a regulated entity's prices is usually the annual revenue allowance which in turn is determined by costs and asset values. To ensure TasWater's revenue allowance for the third regulatory period is based on efficient costs and optimised asset values the Regulator intends engaging expert third party advisors to assist with this aspect of its price determination investigation.

These advisors will be required to undertake an independent review of TasWater’s actual (2015-16 and 2016-17), budgeted (2017-18) and forecast (1 July 2018 onwards) operating and maintenance expenditure and capital expenditure to ensure that only efficient costs are incurred in providing regulated services, and only those assets required to deliver the regulated services, are taken into account in determining the regulated revenue.

#### **2.4.1 Adjustments to the price determination within the regulatory period**

To maximise certainty for TasWater, owner councils, stakeholders and customers, the Pricing Regulations permit price adjustments only if there has been a material change in the costs incurred by TasWater if one or more of the following events occur after the price determination is made:

- new or additional legislative requirements; or
- a tax event (as defined in the Pricing Regulations).

Prices will not be reviewed annually. Rather, TasWater will be responsible for proposing any adjustments to the price determination in line with the determination and the requirements of the Pricing Regulations.

All other variations between forecasts and actual outcomes over the second regulatory period will therefore need to be managed by TasWater including any differences between the forecast and actual Consumer Price Index (CPI).

### **2.5 Data collection template and financial model**

The Regulator will provide TasWater with a data collection template to populate and include as an attachment to its proposed price and service plan. The information provided in the data collection template will assist the Regulator in undertaking the required analysis to complete its investigation and make a price determination within the required timeframe.

The Regulator will calculate annual revenue limits based on information supplied by TasWater in the data collection template issued by the Regulator.

At the same time as submitting its proposed price and service plan to the Regulator, TasWater is also required to provide the Regulator with a copy of the financial model used to develop its pricing proposals.

The Regulator is required, under section 65(5) of the Industry Act, to approve a proposed price and service plan. However, the Regulator may direct changes to be made to a proposed price and service plan to ensure that it complies with a price determination and this Guideline.

## 2.6 Consultation by the Regulator

The Regulator will undertake its own consultation on TasWater’s proposed price and service plan in accordance with its consultation policy and procedures.

All papers and TasWater’s submission will be made available on the Regulator’s website ([www.economicregulator.tas.gov.au](http://www.economicregulator.tas.gov.au)).

The Regulator will also consult with other industry regulators such as the Department of Primary Industries, Parks, Water and Environment, the Director of the Tasmanian Environment Protection Authority and the Director of Public Health.

The Regulator’s consultation expectations for TasWater are outlined in Chapter 3.

## 2.7 Investigation process timetable

The following table summarises the proposed timetable for the third water and sewerage price determination investigation.

**Table 2.1 Proposed timetable for the third price determination investigation**

Action	Due date
Consultation on draft Price and Service Plan Guideline	May 2016
Publish final Price and Service Plan Guideline and issue notice requiring TasWater to submit its proposed price and service plan	1 July 2016
Regulator engages 3 <sup>rd</sup> party advisors for review of TasWater’s Opex and Capex	31 May 2017
TasWater to submit proposed price and service plan, attachments and populated data collection template to Regulator	30 June 2017
3 <sup>rd</sup> party advisors complete review and submit report to Regulator (after discussing recommendations and findings with TasWater)	30 September 2017
Draft report and draft price determination released for public consultation	December 2017
Consultation on draft report and draft price determination closes	End of February 2018
Final report published and final price determination gazetted	April 2018
TasWater to submit revised 2018-21 Price and Service Plan reflecting Price Determination and Final Report	31 May 2018
Regulator approves Price and Service Plan	Mid-June 2018
Third price determination commences	1 July 2018

## **3 CUSTOMER AND STAKEHOLDER CONSULTATION**

The Regulator requires TasWater to consult with its customers and stakeholders during the development of its proposed price and service plan. TasWater must detail the extent and nature of the consultation processes including matters on which it has consulted and customer feedback in response.

TasWater is required to adopt accepted industry practices when undertaking consultation with stakeholders on its proposed price and service plan. The Regulator expects TasWater to consult with stakeholders on matters in its proposed price and service plan such as:

- customer services standards;
- investment decisions;
- proposed tariffs;
- price and service trade-offs;
- proposals to improve product quality (for example, moving from untreated to treated water supply); and
- any proposals to introduce or replace reticulated water and/or sewerage services.

The Regulator expects TasWater to consult with other industry regulators during the preparation of the proposed price and service plan, particularly in relation to the finalisation of its wastewater management plan, drinking water quality plan and dam safety management plan.

TasWater's proposed price and service plan (and any supporting consultation information) must be written in plain English so that it is easily understood by a wide range of stakeholders.

### **3.1 Information required in the proposed price and service plan**

The Regulator requires TasWater's proposed price and service plan to include the following information:

- an outline of the consultation undertaken with industry regulators, customers and stakeholders during the preparation of the proposed price and service plan;
- the objectives of the consultation, specifying issues consulted on and the consultation methods used;

- a summary of feedback received from customer committees, customers and other stakeholders during consultation processes;
- an explanation of how consultation outcomes are reflected in the proposed price and service plan; and
- any significant issues of customer interest the Regulator should be aware of in its consideration of TasWater’s proposed price and service plan – particularly where TasWater has decided not to address these concerns.

## 4 CUSTOMER SERVICE STANDARDS

Customer service standards and conditions should reflect customers' priorities and expectations in relation to service delivery and should underpin TasWater's expenditure plans.

The minimum standards and conditions of service currently outlined in the customer service code (the Code) reflect standards set by the Regulator in relation to water delivery, customer service and response to bursts and leaks. Both the Regulator and TasWater accept that the customer service standards structure should be revised for the third regulatory period.

Subsequent amendments to the relevant clauses of the Code, along with a series of other consequential amendments to the minimum service standards provisions, will be progressed as part of the price determination investigation process.

### 4.1 Approach to developing revised service standards

The Office of the Tasmanian Economic Regulator and TasWater have formed a working group to jointly develop an agreed service standards framework to apply in the third regulatory period. It is anticipated that this framework will be developed by January 2017.

TasWater is required to specify in its proposed price and service plan, the actual minimum service standards and targets that will apply in the third regulatory period, including any transitional performance levels to achieve identified performance targets. The proposed standards are to align with the agreed service standard framework developed by the working group referred to above, unless TasWater is able to justify in its proposed price and service plan why it has departed from this agreed framework.

### 4.2 Regulator's approach to assessing service standards

As part of the price determination investigation, the Regulator will assess whether the proposed service standards and targets:

- are consistent with the agreed service standards framework;
- are consistent with available information on actual performance;
- reflect the impact of proposed expenditure programs; and
- reflect customer preferences (especially any identified priorities for service standard improvement).

The Regulator will consider and, when satisfied, approve TasWater's proposed new minimum service standards and targets during the third price determination

investigation. TasWater should demonstrate that customers have been consulted on their service expectations and that their views have been taken into account.

### **4.3 Information required in the proposed price and service plan**

The Regulator requires that TasWater's proposed price and service plan:

- outlines all proposed service standards and their corresponding targets for each year of the regulatory period, including any transitions to target levels;
- justify any departures from the agreed service standards framework;
- where available, provide historical performance for each service standard;
- demonstrate consultation in establishing any differential service levels; and
- provide evidence of consultation with customer committees and customers and evidence of their support for the proposed service levels.

## 5 OPERATING EXPENDITURE

Under the building block approach, an allowance is made for the efficient cost of operating and maintaining the water and sewerage systems together with the associated administrative costs.

In relation to operating and maintenance expenditure (Opex), the Regulator expects that TasWater will operate efficiently having regard to its operational and regulatory compliance challenges.

For the third regulatory period, the Regulator will examine past Opex and assess current and projected Opex taking into account proposed capital expenditure and any underlying efficiency gains as well as reasons and evidence supporting changes to Opex in the third regulatory period.

### 5.1 Reporting operating expenditure

TasWater must report all Opex in accordance with the framework outlined in the Regulator's Accounting Ring Fencing Guideline (*Water and Sewerage Regulatory Accounting Ring Fencing Guideline* March 2016).

Opex should be split between labour and non-labour costs. The basis for allocating Opex between regulated water and sewerage services and between labour and non-labour components must be clearly identified and justified.

Opex should exclude expenditure associated with unregulated assets used in providing unregulated services. The basis for excluding this expenditure should be identified, justified and take account of the method used to determine the value of the assets excluded from the RAB.

Any forecast significant changes in labour or non-labour Opex (for example, due to additional facilities or functions) must be identified, quantified and justified by TasWater in its proposed price and service plan in the context of the drivers for the change.

As outlined in section 2.4, the Regulator will engage independent third party advisors to review TasWater's Opex values to determine if the proposed levels of expenditure represent efficient costs.

### 5.2 Information required in the proposed price and service plan

TasWater's proposed price and service plan must provide sufficient information for the Regulator to assess TasWater's operating cost forecasts. TasWater's proposal should:

- report all Opex in accordance with the framework outlined in the Accounting Ring Fencing Guideline;

- provide actual annual operating expenditure for past years and annual forecasts for operating expenditure for the third regulatory period and future regulatory periods out to 30 June 2024.
- clearly identify and justify the basis for allocating Opex between regulated water and sewerage services and between labour and non-labour components .
- outline the fixed and variable costs of delivering water to customers' properties.<sup>3</sup>
- identify and justify the basis for excluding (unregulated assets) expenditure in determining the value of the assets excluded from the RAB.
- detail the net savings derived from, or the net costs incurred in, providing re-use water to external parties.
- identify and justify the value of the proposed annual labour productivity factor.
- identify, quantify and justify any forecast significant changes in labour or non-labour Opex (for example, due to additional facilities or functions) in the context of the drivers for those changes.
- explain the trend in forecast operating expenditure having regard to:
  - historic operating expenditure
  - changes in service obligations and targets
  - scope for efficiency improvement
  - changes in operating expenditure by cost category
  - trends in input prices
  - forecast demand
  - proposed capital works
- highlight any other relevant factors including key assumptions underlying the operating expenditure forecasts, any risks to those forecasts and how these uncertainties have been addressed.

---

<sup>3</sup> Tasmanian Economic Regulator, *2015 Price Determination Investigation – Regulated Water and Sewerage Services in Tasmania, Final Report*, page 78.

## 6 CAPITAL EXPENDITURE

Capital expenditure (Capex) is the amount invested in new regulated assets and includes expenditure funded through third party capital contributions.

For the third regulatory period, the Regulator will, therefore, require TasWater to provide the reasons and evidence supporting levels of proposed Capex for that regulatory period and whether the timeframe for delivering the proposed Capex program is reasonable, having regard to the delivery of past Capex.

In reviewing TasWater's Capex during the second regulatory period, the Regulator will assess:

- whether there was a need for TasWater to spend the amounts proposed (ie was the expenditure prudent?); and
- whether the amount spent was the most cost effective approach to achieving the desired outcomes (ie was the expenditure efficient?).

In assessing TasWater's proposed Capex program, the Regulator will consider:

- the prudence and efficiency of Capex in the second regulatory period;
- the reasons and evidence supporting levels of Capex in the third regulatory period;
- whether the timeframe for delivering the proposed Capex program is reasonable; and
- whether TasWater's planning and asset management reflects best practice.

As indicated in Chapter 2, Capex proposed as part of a price and service plan will be independently reviewed as part of the third price determination investigation. In this regard, each Capex proposal must be supported by a business case or other relevant information that demonstrates the proposed expenditure is responding to a cost driver and is both prudent and efficient.

### 6.1 Reporting capital expenditure

Capex should be split between regulated water and sewerage services and consistent with the Accounting Ring Fencing Guideline, classified on the basis of one or more of the following cost drivers:

- Growth: increasing the capacity of assets or construction of new assets, to meet growth in demand or to provide additional security of supply;
- Renewal of existing infrastructure: replacing existing assets and generally maintaining service levels;

- Improvements: improving service levels and reliability to meet customer preferences; and
- Compliance: meeting regulatory obligations.

Where Capex has more than one cost driver, expenditure should be allocated on the basis of the main driver and be consistent with the business case or other relevant information that supports the expenditure.

## **6.2 Information required in the proposed price and service plan**

TasWater's proposed price and service plan must provide sufficient information for the Regulator to assess TasWater's capital expenditure forecasts. TasWater's proposal should:

- provide annual forecasts for capital expenditure for the regulatory period commencing on 1 July 2018;
- provide a breakdown of (historic and forecast) capital expenditure by cost driver;
- explain and justify the trend in forecast capital expenditure;
- outline key assumptions underlying the capital expenditure forecasts including any risks;
- identify major capital projects proposed for the regulatory period commencing on 1 July 2018, for each providing:
  - the project name and scope (including specific outcomes to be delivered);
  - cost category and cost driver;
  - start and completion dates; and
  - total capital cost and expenditure by year.

## 7 REVENUE REQUIREMENT

In making a price determination, the Regulator must adopt an approach and methodology which it considers will best meet the objectives of the Industry Act. The Regulator considers the building block methodology of assessing prices is appropriate for the third regulatory period.

Under the building block approach the revenue requirement for each period reflects the following costs ('building blocks') incurred in providing regulated goods and services:

- operating and maintenance expenditure;
- regulatory depreciation;
- cost of capital - comprising the cost of the debt and equity that together make up the total amount of capital invested in the regulated business.

The value of capital invested in the regulated business is deemed to be equal to the value of the regulated asset base (RAB) ie assets used to provide regulated services. The cost of capital is determined by multiplying the capital invested (RAB) by an appropriate weighted average cost of capital (WACC).

TasWater's proposed price and service plan needs to provide sufficient information and data to enable the Regulator to calculate the revenue requirement. The proposed price and service plan should also specify the annual revenue that TasWater expects to earn based on its proposed tariff structure which includes the application of any proposed regulated price constraints on annual price movements.

### 7.1 Statutory revenue limit

The determination of TasWater's revenue requirements will involve the calculation of a revenue limit that separates the treatment of assets transferred to the previous regulated entities from new assets to provide full cost recovery revenue.

Section 68(1A) of the Industry Act requires the calculation of a statutory revenue limit which is based on a separate WACC (return on capital) for each of the following:

- assets transferred to a regulated entity before 1 July 2011 under Part 3 of the *Water and Sewerage Corporations Act 2008*. The WACC is to incorporate a commercial rate of return on the debt component and a legislated (statutory) pre-tax rate of return of three per cent on the equity component. These will be referred to as **existing** assets; and
- assets purchased or constructed by the previous regulated entities, or TasWater, since 1 July 2009. The WACC is to incorporate a commercial rate of return on both debt and equity. These will be referred to as **new** assets.

The statutory WACC will extend the time it takes to reach full cost recovery revenue based on a commercial rate of return on both debt and equity as the transition rate will depend on the level of investment in new assets.

The statutory revenue limit ( $R_{\text{STATUTORY}}$ ) will be calculated as follows:

$$R_{\text{STATUTORY}} = (RAB_{\text{EXISTING}} \times WACC_{\text{EXISTING}}) + (RAB_{\text{NEW}} \times WACC_{\text{NEW}}) + D + \text{Opex}$$

where:

$RAB_{\text{EXISTING}}$  = value of the regulated asset base in respect of assets transferred to the previous regulated entities before 1 July 2011

$WACC_{\text{EXISTING}}$  = weighted average cost of capital to be applied to assets transferred to the previous regulated entities before 1 July 2011

$RAB_{\text{NEW}}$  = value of the regulated asset base in respect of new assets

$WACC_{\text{NEW}}$  = weighted average cost of capital to be applied to new assets

D = depreciation

Opex = operating and maintenance expenditure

The calculation of the return on assets transferred to the previous regulated entities before 1 July 2011 is based on a separate WACC that assumes a three per cent pre-tax return on equity.

## 7.2 Regulated asset base

The RAB represents the value on which a business can expect to earn a return (return on capital), and the value that is returned to the business over the economic life of the assets (as regulatory depreciation). The RAB is updated each year to reflect any additional capital expenditure (net of contributions), proceeds from asset disposals and regulatory depreciation. It is also adjusted for inflation.

TasWater must establish, maintain and roll-forward two separate RABs: one for assets transferred to the previous regulated entities before 1 July 2011 ( $RAB_{\text{EXISTING}}$ ) and another RAB for “new” assets ( $RAB_{\text{NEW}}$ ) purchased or constructed by the previous regulated entities and the current regulated entity after 1 July 2009<sup>4</sup>.

The RAB for assets transferred to a previous regulated entity before 1 July 2011 will therefore gradually decline over time due to regulatory depreciation and disposals reducing the value of those assets, while the RAB for new assets will increase with expenditure on capital projects.

---

<sup>4</sup> Amongst other things, the *Water and Sewerage Corporation Act 2012* provided for the transfer of the assets and liabilities of the previous regulated entities to the new regulated entity.

Each RAB is split between water and sewerage assets to enable the Regulator to ascertain whether the revenue from each regulated service relates only to the costs associated with providing that service.

The opening RAB<sub>EXISTING</sub> and RAB<sub>NEW</sub> are based on DORC<sup>5</sup> asset values as at 1 July 2015 which have been rolled forward from 1 July 2009.

### 7.2.1 Opening RAB

The opening RAB as at 1 July 2018 will be calculated as follows (by undertaking the following roll-forward calculation for each year of the second regulatory period):

$$\begin{aligned} \text{opening RAB} &= \text{RAB at 1 July 2015} \\ &+ \text{actual capital expenditure} \\ &- \text{customer contributions} \\ &- \text{regulatory depreciation} \\ &- \text{proceeds from asset disposals} \end{aligned}$$

Capital expenditure between 1 July 2015 and 30 June 2018 (ie the second regulatory period) must be both prudent and efficient to be included in the opening RAB at 1 July 2018. Independent third party advisors will be engaged to assess whether past projects have been delivered cost-effectively and that any departures from previously approved expenditure are justified.

TasWater's proposed price and service plan must:

- explain and reconcile actual Capex with forecast Capex for the second regulatory period from 1 July 2015 to 30 June 2018;
- reconcile expenditure for major projects identified in its Price and Service Plan for the second regulatory period; and
- explain and quantify Capex undertaken or expected to be undertaken between 1 July 2015 and 30 June 2018 that TasWater seeks to recover from regulated customers but not planned at the time of the 2015 price determination investigation.

### 7.2.2 Roll forward RAB

In calculating the statutory revenue limit, the new assets RAB and the RAB based on assets transferred to the previous regulated entities before 1 July 2011 will need to be rolled forward on a separate basis.

---

<sup>5</sup> Depreciated Optimised Replacement Cost

The RAB in each financial year will be based on the average of the opening RAB (ie the RAB as at 1 July in the relevant financial year) and closing RAB (ie the RAB as at 30 June in the relevant financial year).

The opening RAB value in each financial year is equal to the closing balance from the previous financial year.

For each financial year, the closing RAB value will be calculated as follows:

Opening RAB value  
 + capital expenditure  
 - regulatory depreciation  
 - asset disposals  
 - third party capital contributions  
 = closing RAB value

Third party capital contributions include developer charges service introduction charges and government grants. Developer charges include headworks charges, gifted assets and cash paid by developers to TasWater for the construction of new reticulation works.

The roll forward RAB will also be adjusted, if necessary, to account for the recommendations made by the third party advisors following the completion of their review of TasWater's Capex.

### **7.2.3 Contributions**

Third party capital contributions are assets contributed by third parties that are not funded by TasWater and include developer charges, service introduction charges and government grants. Third party capital contributions are netted off the value of the RAB as TasWater is not permitted to receive a return on capital, or return of capital, that it did not fund.

TasWater's proposed price and service plan should provide separate data and information on:

- government contributions;
- customer contributions; and
- the value of gifted assets

TasWater should also provide estimates of the total contributions by type and identify any contributions to major projects.

## 7.2.4 Regulatory depreciation

A separate proposed regulatory depreciation rate will need to be calculated for each RAB. Each proposed regulatory depreciation rate should be calculated on a straight-line basis having regard to the respective assets' average useful life (as per the Accounting Ring Fencing Guideline). Each regulatory depreciation rate will then be applied throughout the third regulatory period.

For the purpose of the asset roll forward for each financial year, regulatory depreciation should be calculated by applying the proposed depreciation rate to the sum of the opening RAB value and 50 per cent<sup>6</sup> of Capex (net of third party capital contributions and asset disposals). That is, it is assumed that revenue is realised, and capital expenditure occurs, evenly throughout each financial year.

Regulatory depreciation on new assets ( $D_{NEW}$ ) in each financial year is calculated as follows:

$$D_{NEW} = DR_{NEW} \times (NEW\ RAB_{OPENING} + (0.5 \times (Capex - CC - AD_{NEW})))$$

Where:

$DR_{NEW}$	=	regulatory depreciation rate for new assets
Capex	=	capital expenditure
$NEW\ RAB_{OPENING}$	=	opening value of new assets RAB
CC	=	third party capital contributions
$AD_{NEW}$	=	new asset disposals

The proposed regulatory depreciation rate used to calculate the revenue limit should be the same as that applied to roll forward the RAB in each financial year of the second regulatory period.

Regulatory depreciation for the roll forward on existing assets ( $RAB_{EXISTING}$ ) is calculated on the same basis as outlined above (except there is no capex or third party capital contributions in the RAB incorporating assets transferred to the previous regulated entities before 1 July 2011).

---

<sup>6</sup> The Regulator's 'mid-year assumption' assumes that half of the capex is incurred at the beginning of the year and the other half occurs at the end of the year. Similarly, in the year an asset is disposed, 50 per cent of the disposals are subtracted from the opening RAB.

Regulatory depreciation on existing assets ( $D_{\text{EXISTING}}$ ) in each financial year is calculated as follows:

$$D_{\text{EXISTING}} = DR_{\text{EXISTING}} \times (\text{EXISTING RAB}_{\text{OPENING}} + (0.5 \times (\text{AT} - AD_{\text{EXISTING}})))$$

Where:

$DR_{\text{EXISTING}}$	=	regulatory depreciation rate for existing assets
$\text{EXISTING RAB}_{\text{OPENING}}$	=	opening value of existing assets RAB
$AD_{\text{EXISTING}}$	=	existing asset disposals
AT	=	assets transferred to a regulated entity before 1 July 2011

The proposed regulatory depreciation amounts calculated above should be used in the respective RAB roll forwards incorporating assets transferred to the previous regulated entities before 1 July 2011 and the new assets RAB as well as in the calculation of the statutory revenue limit.

### 7.3 Rate of return

For assets transferred to the previous regulated entities before 1 July 2011, the WACC will incorporate a commercial rate of return on the debt component and a legislated pre-tax rate of return of three per cent on the equity component.

For new assets, the WACC will incorporate a commercial rate of return on both debt and equity.

#### 7.3.1 Weighted average cost of capital

Under a building block approach, the return on the RAB is calculated using the WACC. In line with accepted regulatory practice, a benchmarked debt to equity ratio is used in determining the WACC.

The WACC can be set on a real or nominal, pre-tax or post-tax basis. There is little consistency across Australia in terms of the type of WACC adopted for the water and sewerage industry. In line with its practice for the first and second water and sewerage price determination investigations, the Regulator proposes to adopt a real pre-tax WACC based on the following formula:

$$\text{WACC}_{\text{nominal}} = R_d \times G + R_e \times \left( \frac{1}{(1-t(1-\gamma))} \right) \times (1-G)$$

$$\text{WACC}_{\text{real}} = \left( \frac{(1 + \text{WACC}_{\text{nominal}})}{(1+i)} \right) - 1$$

Where:

Re	=	Cost of equity (post-tax)
	=	$R_f + \beta_e \times (R_m - R_f)$
Rd	=	pre-tax cost of debt
Rm	=	market return
Rf	=	risk free rate
t	=	corporate tax rate
$\beta_e$	=	equity beta
G	=	gearing ratio
i	=	forecast inflation (annual average over regulatory period)
$\gamma$	=	gamma <sup>7</sup>

As noted above, there are two separate WACCs required for the calculation of the statutory revenue limit. The formula for the WACC on assets transferred to the previous regulated entities before 1 July 2011 is therefore as follows:

$$\text{EXISTING WACC}_{\text{NOMINAL}} = (R_d \times G) + (Z \times (1 - G))$$

Where:

Z	=	Statutory pre-tax return on equity
Rd	=	pre-tax cost of debt
G	=	gearing ratio

The conversion from a nominal to real WACC for assets transferred to the previous regulated entities before 1 July 2011 is the same as outlined above for the full commercial WACC.

As for the full commercial WACC the Regulator will determine the EXISTING WACC<sub>real</sub> value after considering TasWater's proposed WACC parameter values submitted in its proposed price and service plan. The EXISTING WACC<sub>real</sub> determined by the Regulator will be used to calculate the statutory revenue limit that will apply under the final Price Determination.

TasWater is to propose a value for each of the components for the WACC listed at Table 7.1 below, and provide justification for each proposed value.

---

<sup>7</sup> Represents the proportion of imputation credits which can be utilised by shareholders and varies between 0 and 1.

**Table 7.1 WACC components**

Components	
$R_e$	cost of equity (post tax)
$R_d$	pre-tax cost of debt
$G$	gearing ratio
$R_m$	market return
$R_f$	risk free rate
$\beta_e$	equity (beta)
$i$	forecast inflation
$\gamma$	gamma

In determining an appropriate WACC the Regulator will consider TasWater's proposed values and take into account prevailing market conditions and recent decisions by other regulators.

#### 7.4 Treatment of assets used to provide unregulated services

Assets associated with providing unregulated services are to be excluded from the RAB in accordance with Regulator's Accounting Ring Fencing Guideline<sup>8</sup> (the Ring Fencing Guideline).

Unregulated services include:

- providing water for irrigation;
- reusing water, discharged from a sewage treatment plant, for irrigation; and
- providing stormwater services via a combined sewerage/stormwater system.

The costs of, and return on, assets used to provide unregulated services (unregulated assets) should be recouped from the users of those services.

The Regulator needs to be satisfied that unregulated services are correctly classified and excluded from the regulated cost base. TasWater's proposed price and service plan should clearly identify each service provided that has been treated as unregulated and explain how shared costs (such as corporate costs) have been allocated between regulated and unregulated services, according to the ring fencing guideline.

<sup>8</sup> Tasmanian Economic Regulator, *Water and Sewerage Accounting Ring Fencing Guideline* (Version 2), March 2016.

## **7.5 Information required in the proposed price and service plan**

The Regulator requires TasWater to complete the data collection template that will be issued by the Regulator and submit the completed template to the Regulator with its proposed price and service plan.

## 8 TARIFF LEVELS AND STRUCTURES

During the third regulatory period, it is expected that TasWater's tariffs will complete the transition to a rational price structure with all customers on target tariffs.

The Regulator will consider TasWater's tariff proposal against the pricing principles out in section 68 of the Industry Act. The pricing principles for tariffs say that the price for the provision of a regulated service must:

- give a regulated entity reasonable opportunity to recover the efficient costs it incurs in providing those services or complying with its regulatory obligations;
- provide for efficient two-part, cost-reflective pricing;
- provide effective incentives to promote economic efficiency, reduce costs, or otherwise improve productivity;
- allow a regulated entity to receive a return on assets used in providing the regulated service; and
- to the extent that it is commercially and technically reasonable, reflect the costs that are directly attributable to a particular customer or class of customers.

In proposing a tariff structure as part of its price and service plan TasWater is required to propose and clearly set out for each pricing zone a tariff (or target tariff) for each regulated service by customer class, for each financial year of the third regulatory period.

TasWater's tariff structure proposal should also consider price constraints to limit the movement of tariffs in a year to ensure that customers do not face significant changes to prices in any one year.

Miscellaneous fees and charges<sup>9</sup> must be determined according to the pricing principles in the Industry Act and the Pricing Regulations and be included in TasWater's proposed price and service plan.

The proposed price structure should take account of the proposed customer classes as set out in section **Error! Reference source not found..**

---

<sup>9</sup> All fees and charges that may be charged by a regulated entity and that are not fixed charges, variable charges, developer charges or service introduction charges.

## 8.1 Pricing zones

A pricing zone is a region where ultimately the prices charged to customers will be the same for the same service (ie the same sets of prices will apply to each customer class). A pricing zone could cover the entire region serviced by TasWater (which would equate to ‘postage stamp’ pricing) or there could be a number of zones within the region (nodal pricing).

The Pricing Regulations set out the circumstances where pricing zones may be included in a proposed price and service plan. Where TasWater proposes adopting pricing zones the pricing zones must be clearly identified (for example, via maps) and justified on the basis of cost differentials in providing a regulated service.

## 8.2 Customer classes

The Regulator requires TasWater to describe and justify any changes to the customer classes approved by the Regulator for the second regulatory period.

Water customers and sewerage customers are considered to be different customer classes, reflecting the different costs associated with providing a different service and product. Customer classes approved as part of the 2015 Price Determination Investigation include:

- full service (water) customers;
- full service (sewerage) customers;
- limited water quality customers;
- limited water supply customers; and
- combined limited water quality and limited water supply customers.

Trade waste customers were also approved as a separate customer class with four sub classes (Categories 1, 2A, 2B and 2C) using a technical and commercial risk assessment of trade waste impacts on the sewerage system as the basis for categorising and calculating trade waste charges.

As part of its 2015 Price Determination Investigation, the Regulator also recognised the different costs associated with septic tank effluent disposal schemes (STEDs). Customers using STED schemes are therefore considered to be a separate customer class.

TasWater’s proposal must outline customer classes that reflect the differential cost of providing regulated services to each customer class. Where TasWater proposes a change to the existing approved customer classes, justification should be provided on the basis of furthering achievement of the pricing principles.

### **8.3 Water charges**

As noted above, the Pricing Regulations specify that water prices must provide for efficient two-part, cost-reflective pricing.

Additionally, the amount of the variable water usage charge for a property must at least cover the cost of delivering water to that property. This means that variable charges should ordinarily be set to recover only variable costs directly related to providing water to the property.

Where TasWater proposes levying a variable charge greater than the cost of delivering water or removing sewage TasWater must identify, quantify and justify the other costs to be recovered through variable charges in its proposed price and service plan.

### **8.4 Sewerage charges**

For the first and second regulatory periods, fixed sewerage charges have been calculated using an Equivalent Tenement (ET) methodology. An ET is a measure of the load a property places on the sewerage system.

If TasWater intends continuing with an ET methodology, it must justify (including in terms of the resultant ETs being cost reflective), and describe how it intends to apply its ET methodology, including explaining how the number of ETs has been determined for each property use type.

The Regulator also requires TasWater to include in its proposal a schedule of proposed ETs for different industries/property use types.

### **8.5 Information required in the proposed price and service plan**

TasWater's pricing proposal should:

- include a proposed tariff structure (including proposed prices for each year of the third regulatory period in nominal terms);
- clearly identify any proposed pricing zones (for example, via maps) and justify the basis for differences in cost in relation to the provision of a regulated service in different pricing zones;
- describe and justify any changes to the customer classes;
- for each tariff, quantify and justify fixed and variable charges; and
- describe and justify the methodology it intends adopting for determining sewerage and trade waste charges for the third regulatory period.

TasWater's proposed price and service plan must also provide details of proposed fees and charges with respect to all miscellaneous services TasWater is intending to provide during the third regulatory period.

## 9 PRICE REGULATION

From the commencement of independent regulation of water and sewerage prices in Tasmania on 1 July 2012 through to the end of the second regulatory period on 30 June 2018, it has been constraints on price movements that have been determining prices as customers have continued to transition to uniform target tariffs. While the Regulator has been calculating revenue limits as part of its price determination investigations, expected revenue has been below the binding statutory limit during this time.

However, TasWater’s total revenue has been transitioning towards the statutory limit and it may be that this limit will apply in the third regulatory period. Therefore, it will be necessary for TasWater to demonstrate that its pricing proposals, combined with forecasts of water demand, customer numbers and the number of miscellaneous charge transactions, result in a total expected revenue that is equal to or below the calculated statutory revenue limit.

For the third regulatory period it is expected that the following price reforms will need to be managed:

- completing the transition of all customers to the relevant target tariff by 30 June 2020;
- underlying movements in target tariffs to continue the transition to the statutory revenue limit and fund required regulatory compliance improvement;
- making any changes to the level of miscellaneous charges; and
- implementing the outcomes of any proposed changes to TasWater’s tariff structure or customer classes, as discussed in the previous chapter.

The structure and quantum of these proposed price changes will depend upon an assessment of the ability of TasWater to achieve price reform in a manner that manages the impact of the rate of change of prices for customers whilst also addressing competing needs such as facilitating improved regulatory compliance.

Consistent with the “propose and respond” nature of the regulatory framework, the Regulator considers that TasWater is best placed to develop models to support pricing proposals and assess customer impacts as it holds detailed customer and usage information.

Any proposed movements in price, or constraints upon price movements, will be assessed by the Regulator based on the following objectives:

- completing the transition of all customers to the relevant target tariff by 30 June 2020;
- managing the impact of price changes on customers;

- provide effective incentives to promote economic efficiency, reduce costs or otherwise improve productivity with respect to a regulated service

TasWater is also required to demonstrate that proposed price movements, or constraints upon price movements, have been informed by feedback from consultation with customers and industry regulators.

As part of the price determination investigation the Regulator will review TasWater's price constraint proposals and may require TasWater to develop alternative scenarios during the investigation process.

### **9.1 Information required in the proposed price and service plan**

TasWater's pricing proposal should:

- explain and justify any proposed price movements including any constraints upon price movements;
- explain and justify how the transition of all customers to the relevant target tariff will be achieved by 30 June 2020;
- demonstrate and quantify expected customer impacts of proposed price movements and any proposed price constraints; and
- be supported by a model (that TasWater will provide to the Regulator if requested) that:
  - is based on TasWater's Regulatory Financial Statements (as defined in the Accounting Ring Fencing Guideline); and
  - includes the calculations used to develop the proposed pricing proposals.

## 10 CUSTOMER CONTRACT AND POLICIES

TasWater’s proposed price and service plan must include a range of documents and policies in relation to the services it provides, connections and charges.

TasWater’s submission must also include a general discussion of its approach to setting policy parameters and any additional information regarding issues addressed by the policies.

TasWater must develop a customer contract that is in accordance with the customer service code (the Code) for regulated services that it proposes using during the third regulatory period.

A description of serviced land must be included with the price and service plan that complies with the Industry Act and the Code and underpins the policies listed below and which is sufficiently detailed to identify individual titles. TasWater must also outline the factors and considerations it may rely upon in determining and justifying whether land is serviced land.

In addition, TasWater’s proposed price and service plan must include copies of all policies relating to customers, connections and charges as listed below and as required by the Industry Act, the Pricing Regulations and the Code. TasWater is free to combine these policies where it can demonstrate that this provides for a more efficient approach and improved clarity for customers and provided it does not contravene any relevant legislative requirements.

TasWater must also explain and justify any differences between its current policies and the policies it is proposing for the third regulatory period.

Once approved, TasWater must publish these policies and any supporting documentation on its website.

### 10.1 Information required in the proposed price and service plan

TasWater is required to develop and submit for review and approval with its proposed price and service plan:

- a customer contract for regulated services; and
- a sufficiently detailed description of serviced land.

TasWater is also required to develop, and submit for review and approval with its proposed price and service plan, policies with regards to:

- connections;
- service charges;

- trade waste charges;
- sub-metering;
- extension and expansion;
- service introduction charges; and
- developer charges.

TasWater's proposed price and service plan is required to include anticipated changes, over time, of any prices specified in the plan.

## **10.2 Service replacement proposals**

Service replacement involves replacing reticulated services with other arrangements, most commonly replacing reticulated water supply with water tanks. The Regulator, as part of its 2015 Price Determination Investigation, approved a service replacement process that was required to be reflected in TasWater's price and service plan for the second regulatory period and must be followed by TasWater when considering whether to replace a service.

If TasWater proposes any changes to the service replacement process approved for the second regulatory period, it will need to clearly justify any departures from the current process including evidence of consultation with stakeholders.

The Regulator will not require specific service replacement proposals to be submitted for approval as part of TasWater's proposed price and service plan.

However, the Regulator expects that TasWater's proposed price and service plan will identify areas where it has undertaken preliminary analysis and community consultation in respect to the potential replacement of an existing service and to provide information in line with the above considerations, where it has that information.

# 11 DEMAND FORECASTS

Demand forecasts are a key input into the determination of prices and are relevant to the assessment of past and forecast capital expenditure and operating expenditure. The amount of forecast regulated revenue for each financial year of the third regulatory period depends on tariffs, customer numbers, water usage and demand for miscellaneous services for each year.

Revenue forecasts for in each financial year of the third regulatory period should be underpinned by forecasts of:

- customer numbers;
- water demand; and
- number of transactions for which a miscellaneous fee applies (see the Regulator's *2015 price determination investigation final report* for a list of fees and charges).

## 11.1 Information required in the proposed price and service plan

TasWater's proposal should summarise its demand forecasts and the key assumptions adopted to develop those forecasts.

The following data is required to be submitted in TasWater's proposed price and service plan in respect of each financial year of the second regulatory period:

- actual customer numbers;
- actual water demand;
- actual number of transactions for which a miscellaneous fee applied; and
- an explanation of the reasons for the variations between the forecast and actual water demand volumes for the second regulatory period.

TasWater must include in its proposed price and service plan for each proposed water tariff information to enable a build-up of total estimated water tariff revenue including items such as:

- forecasts of water demand for each financial year of the third regulatory period; and
- forecasts of customer numbers by connection size for each financial year of the third regulatory period.

TasWater must also include in its proposed price and service plan sufficient information to enable the build-up of total estimated sewerage and trade waste revenue.

For each proposed miscellaneous services fee TasWater must include in its proposed price and service plan forecasts of the estimated number of transactions for each financial year of the third regulatory period.

TasWater must also include in its proposed price and service plan the key assumptions that underlie these forecasts. The same forecasts must be used for both revenue estimates and for future capital expenditure.



## 12 REGULATORY COMPLIANCE

TasWater is not currently fully compliant with its regulatory obligations. Due to the legacy issues inherited by the previous regulated entities and now TasWater, it is acknowledged that full compliance will not be able to be achieved for some time. Compliance improvement plans and programs are, therefore, needed to ensure that the industry regulators' priority compliance improvement expectations are met.

Each individual industry regulator is responsible for enforcing TasWater's compliance with its regulatory obligations.

The Regulator expects TasWater to consult with each industry regulator during the preparation of its proposed price and service plan to ensure that compliance improvement outcomes over the third regulatory period meet the expectations of each industry regulator.

Improvements in regulatory compliance are usually achieved through capital expenditure, but may also be achieved through achieving efficiency in operating and maintenance expenditure.

The proposed capital, operating and maintenance expenditure contained in the proposed price and service plan must, therefore, reflect these agreed compliance improvement outcomes.

The Tasmanian industry regulators are:

- the Director of Public Health, who is responsible for regulating water quality and fluoridation;
- the EPA, which is responsible for regulating wastewater treatment plants; and
- DPIPWE, which is responsible for water licence allocations and dam safety.

### 12.1 Approach to reviewing compliance

The appropriateness of expenditure proposals in the proposed price and service plan, and the resultant compliance improvement outcomes, will be reviewed as part of the price determination investigation.

The Regulator will consult with other industry regulators to ensure that the agreed compliance improvement outcomes are reflected in the proposed price and service plan. The Regulator may recommend changes to the price and service plan to ensure that the statutory responsibilities of industry regulators are appropriately addressed. Any proposed changes will be subject to public consultation following the release of the draft report and draft price determination.

Additionally, Capex incurred during the second regulatory period (including Capex for compliance improvement purposes), will be reviewed as part of the third price

determination investigation to ensure that Capex included in the RAB reflects efficient levels of expenditure.

## **12.2 Information required in the proposed price and service plan**

The Regulator requires TasWater's proposed price and service plan to include:

- a summary of the expectations of each industry regulator for the third regulatory period;
- a list of the agreed compliance improvement outcomes including target dates for major projects;
- an explanation of how the proposed capital, operating and maintenance expenditure contained in the proposed price and service plan reflect these agreed compliance improvement outcomes;
- a review of how capital expenditure undertaken during the second regulatory period reflects efficient levels of expenditure; and
- copies of its wastewater management plan, drinking water quality management plan and dam safety management plan (to be subsequently approved by the relevant industry regulator).