

# STATEMENT OF REASONS

## PROPOSED CHANGES TO TASWATER'S REGULATORY FRAMEWORK

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### BACKGROUND

In response to the Regulator's [Draft Price and Service Plan Guideline](#), TasWater proposed a number of changes to its regulatory framework, including<sup>1</sup>:

- carrying out an annual price reset and indexing prices annually to allow for inflation outcomes;
- updating annually the cost of debt component of TasWater's return on capital;
- regulating trade waste charges for Category 3 and 4 (industrial) trade waste customers; and
- considering whole-of-system water and wastewater outcomes when making investment decisions.

The Regulator published an [Issues Paper](#) on 10 May 2024 to obtain input from stakeholders regarding TasWater's proposed changes, with consultation closing on 7 June 2024.

The Regulator received a number of written submissions and met with interested parties during the consultation period. The submissions and summaries from the meetings are available on the Regulator's [website](#). Table 1 provides a summary of the responses received during consultation.

The changes proposed by TasWater would significantly change the regulatory approach for regulating water and sewerage in Tasmania. TasWater has indicated that these changes would bring the regulatory system in Tasmania more in line with the way other water utilities in Australia are regulated. It also argues that the current regulatory system exposes it to risks of not being able to recover its full costs.

In making a decision on these proposals, the Regulator notes that TasWater is working on improving its data availability and integrity across the business and will continue to do so into the future. As the veracity of TasWater's data improves, the Regulator will be better placed to understand the impacts on TasWater's customers if the proposals were implemented.

The Regulator has considered all of the issues presented to it by TasWater and the feedback received during consultation. The Regulator's view is that given the scepticism of many stakeholders, the significant change to the regulatory approach implied by the proposed changes, coupled with the need to understand more fully the impact on customers, a deeper and broader review of the current and alternative regulatory approaches will need to be undertaken before such significant changes could be made to the regulatory framework.

However, the Regulator notes that he is committed to ensuring that TasWater can raise sufficient revenue to deliver its services and meet its commitments. In this context, the Regulator will continue to explore approaches to address the concerns that TasWater has raised in the lead up to its submission of its proposed Price and Service Plan.

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<sup>1</sup> TasWater also proposed the duration of the next regulatory period be extended. The Regulator's response to this proposal was set out in the [Statement of Reasons](#) issued on 26 June 2024.

This Statement sets out the Regulator's position in relation to each of TasWater's proposals.

## ANNUAL INDEXATION OF WATER AND SEWERAGE PRICES

TasWater proposed moving to a real price framework for the fifth regulatory period. Under this proposal, prices for each year of the regulatory period would be indexed by actual inflation over the previous 12 months, for example, prices for 2026-27 would be indexed to account for actual inflation outcomes in 2025-26.

TasWater's submission on the Issues Paper stated that its proposal is aimed at ensuring that prices are more cost-reflective during a regulatory period and that neither it, or its customers, are exposed to the risk of arbitrary windfall gains or losses. Furthermore, TasWater stated that moving to a real pricing framework would likely create minimal price volatility or uncertainty and help avoid larger 'step changes' in prices that may occur between regulatory periods where costs have materially deviated from forecasts within a period.

Feedback received during consultation indicated that stakeholders do not support the proposal to move to annual price indexation. The main reasons cited by stakeholders include:

- the change would move the management of inflation forecasting risk from TasWater to its customers;
- frequent price changes could create financial instability for households and businesses, making it difficult for them to budget and plan effectively;
- a strength of the current multi-year pricing determination is the price stability and predictability it provides to customers; and
- an annual price adjustment to account for inflationary outcomes does not incentivise efficiency within TasWater.

The Regulator has a statutory responsibility to allow TasWater to recover sufficient revenue to cover its efficient costs while incentivising TasWater to identify efficiencies, reduce costs or otherwise improve productivity. TasWater has expressed concerns about its exposure to inflation risk and its ability to recover sufficient revenue.

In the context of these responsibilities and TasWater's concerns, the Regulator notes that, as forecast inflation has already been factored into TasWater's cost components, annual indexation of prices to account for actual inflation would only adjust for the difference between the forecast inflation and actual inflation. While actual inflation in the past two years has outpaced forecast inflation, this could be reversed in the last two years of the current regulatory period or in the next regulatory period, as occurred during the third regulatory period where forecast inflation was above actual inflation.

The Regulator acknowledges that the change from an environment of low inflation to the current high inflationary environment may have created some challenges for TasWater. The Regulator will work with TasWater to ascertain the impact of this on TasWater's revenue.

However, it is important to note that inflationary expectations have likely adjusted upwards and so the risk of significant difference between forecast and actual inflation is likely to be less in the future. To deal with any remaining risk for the next regulatory period, the Regulator will work with TasWater to set an appropriate inflation forecast.

The Regulator also notes that TasWater's proposal to index its prices could result in prices and costs diverging over time, as movements in many of TasWater's costs are not directly linked to inflation. This would mean that over time, prices may not reflect TasWater's efficient costs, a fundamental principle of the regulatory framework.

Based on the issues set out in the Issues Paper and the stakeholder feedback received, the Regulator has decided not to introduce an annual indexation of water and sewerage prices for the fifth regulatory period. However, the Regulator considers that the merits of this proposal could be explored in more detail for future regulatory periods.

Further, as indicated above within the current regulatory framework, the Regulator intends continuing to work with TasWater in the lead-up to the submission of its proposed Price and Service Plan and is prepared to explore alternative approaches, to address the concerns TasWater has raised.

## ANNUAL RECALCULATION OF THE COST OF DEBT

TasWater proposed the introduction of an annual update to the Weighted Average Cost of Capital, where the trailing average cost of debt value is updated in each year of a regulatory period. Under this proposal, movements in TasWater's prices will vary year on year, depending on the changes in the allowed cost of debt.

In TasWater's proposal, it considered that updating the cost of debt annually would:

- result in better alignment between the regulatory allowance and the "prudent and efficient" cost of debt;
- avoid customers or TasWater receiving or incurring windfall gains and losses (TasWater considers windfall gain or losses as "prices that are too high or too low relative to efficient levels");
- provide a closer match between the efficient cost of debt and the regulatory allowance and will therefore provide TasWater with "strong[er] incentives for efficient investment"; and
- allow prices to be adjusted downwards within the regulatory period to reflect falling costs where interest rates fall over the regulatory period.

In its submission to the Issues Paper, TasWater stated that Tasmania is the only jurisdiction in Australia using a trailing average approach to the cost of debt that does not allow for an adjustment to reflect how the cost of debt actually changed over the period. Furthermore, TasWater stated that the proposal would ensure that prices are cost reflective and ensure that neither it, or its customers, are subject to windfall gains or losses, which in turn will promote efficient investment and consumption decisions which are in the long-term interest of customers.

Feedback received during consultation indicated that most stakeholders do not support the introduction of an annual recalculation of TasWater's cost of debt. The main reasons cited by stakeholders include:

- TasWater does not face fluctuations in its debt year on year, with most of its debt being of a long-term nature;
- the proposal includes a risk transfer from TasWater to its customers;
- the current method provides incentives for TasWater to develop efficient financing solutions and ensure that forecasts are accurate and well founded; and
- an annual price reset will increase the administrative burden for TasWater and the Regulator.

Based on the issues set out in the Issues Paper and the stakeholder feedback received, the Regulator has decided not to introduce an annual recalculation of TasWater's cost of debt for the fifth regulatory period.

In particular, the Regulator notes the stakeholder feedback that TasWater, not its customers, is best placed to manage the risk associated with the forecast cost of debt and further notes that TasWater has a range of tools available to manage its cost of debt risk.

Furthermore, as the Regulator noted in the Issues Paper, to date TasWater's customers have had price certainty for the duration of each regulatory period. Stakeholder feedback has confirmed that this is particularly highly valued in the current environment where there is an increased focus on the cost of living, particularly on non-discretionary expenditure such as utility bills.

## REGULATION OF PRICING FOR CATEGORY 3 AND 4 TRADE WASTE CUSTOMERS

Under the current framework, the trade waste charges for these customers are not regulated and TasWater negotiates individual contracts with each customer.

TasWater proposed regulating trade waste charges for these customers on the basis that it would:

- provide a fairer approach to pricing whereby all trade waste customers will be charged based on a uniform approach across Tasmania;
- be simpler for customers to understand and provide customers and the private market with transparency and trust in the price setting process;
- reduce the administrative effort for TasWater and customers when assessing and agreeing on pricing arrangements; and
- provide a common framework for all trade waste customers, given some businesses will move from commercial trade waste categories to the industrial trade waste categories if their business expands.

In its submission to the Issues Paper, TasWater stated that some other utilities in Australia have regulated trade waste prices for industrial customers, with guidelines that explain how cost-reflective trade waste prices can be set for a diverse range of customers. Further, TasWater noted that regardless of the size of the customer, trade waste is a monopoly service, and that regulation of prices would provide benefits.

Feedback received from stakeholders during consultation in relation to this proposal was mixed. Some stakeholders expressed support on the basis that regulating industrial customers' trade waste charges would increase transparency and prevent small business customers cross-subsidising industrial customers. Feedback was also received acknowledging that some Category 3 and 4 trade waste customers are likely to be employers of state significance and if these businesses were to be negatively impacted by the regulation of their trade waste prices, the Government could subsidise them in a transparent manner instead of having smaller customers provide cross-subsidies.

Stakeholder feedback that did not support the proposal stated that price regulation for this cohort of customers was specifically not adopted due to the recognition that the size and capabilities of these customers are such that, if they wish, they can install their own pre-treatment systems to convert trade waste to sewer quality and, as such, TasWater is not a monopoly supplier of trade waste services to these customers. Further, as stated in the Issues Paper, these customers are diverse in nature and may require bespoke trade waste solutions, and it was noted that this situation does not lend itself well to a regulated pricing solution.

In considering the issues raised and the feedback received during consultation, the Regulator also notes that TasWater has been reviewing its trade waste arrangements. Among other things, this review has resulted in the majority of the contracts for Category 3 and 4 trade waste customers being re-negotiated, with the new pricing framework publicly available on TasWater's website.<sup>2</sup> This has significantly increased the transparency of the charging arrangements for this cohort of customers and may allay stakeholders' concerns about potential cross-subsidisation between regulated and non-regulated trade waste customers.

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<sup>2</sup> TasWater's current pricing for Category 3 and 4 trade waste customers is available here: [Pricing for Industrial Trade Waste Customers for 2024-25](#)

Additionally, as part of its broader review of its trade waste arrangements, TasWater is investigating the costs of providing trade waste services to its Category 3 and 4 trade waste customers. In the absence of this cost data, it is not possible for the Regulator to understand the pricing impacts on this cohort of customers if price regulation was introduced.

In this context, the Regulator considers that the next regulatory period may not be an appropriate time to implement price regulation for Category 3 and 4 trade waste customers.

## CONSIDERING WHOLE-OF-SYSTEM WATER AND WASTEWATER OUTCOMES

TasWater proposed using a whole-of-system approach to planning and considering its investments. This proposal includes non-traditional solutions where it is the least cost solution or it is not the least cost means of supplying water and sewerage services to required standards, but customers are willing to pay for the outcomes generated (for example, environmental outcomes above the level mandated by regulations).

Under the current framework, the Regulator assesses TasWater's proposed capital expenditure projects based on whether each project:

- is necessary to deliver regulated services (prudent);
- is demonstrated to provide regulated services at the lowest long-term cost (efficient); and
- is consistent with TasWater's compliance obligations and longer-term plans.

As noted in the Issues Paper, the Regulator has not identified any aspects of the current framework that would prevent TasWater from proposing whole-of-system approaches to its capital investments.

Feedback received during consultation indicated that stakeholders either considered that there was insufficient information about this proposal to fully understand it or be able to assess it or were not supportive of the proposal. In particular, stakeholders indicated that they did not support the proposal due to concerns that it would increase costs for regulated water and sewerage customers at a time when the cost of living was increasing. Furthermore, feedback was received that where a non-traditional investment is not the least cost solution, but other benefits would be realised, those beneficiaries should pay for the investment rather than having the costs imposed on all regulated water and sewerage customers.

TasWater's submission on the Issues Paper provided further information regarding how whole-of-system impacts and customers' willingness to pay could be assessed.

Based on the issues raised and the feedback received during consultation, the Regulator has decided that no changes are required to the regulatory framework to allow TasWater to consider whole-of-system water and wastewater outcomes when planning and making investment decisions. That is, TasWater is free to consult with customers and, subject to the feedback received, include this approach in its proposed Price and Service Plan for the fifth regulatory period. The Regulator will continue to assess TasWater's proposed capital expenditure projects based on whether they are prudent and efficient. It is open to TasWater to demonstrate broader system-wide costs and benefits in establishing prudence and efficiency.

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**TABLE 1: SUMMARY OF CONSULTATION FEEDBACK**

Stakeholder	Annual indexation of prices	Annual cost of debt recalculation	Price regulation of Category 3 and 4 trade waste customers	Whole-of-system outcomes
Tasmanian Small Business Council	Do not support	Do not support	Requested more information	Do not support
TasCOSS	Support with price cap	No direct feedback	No direct feedback	Do not support
Council on the Ageing Tasmania	Support with price cap	Support	No direct feedback	Do not support
Salvation Army	No direct feedback	No direct feedback	No direct feedback	Do not support
Nekon Pty Ltd	Do not support	Do not support	Support	Do not support
Tasmanian Chamber of Commerce and Industry	Support	Do not support	Support	Requested more information
Property Council of Australia (Tasmania)	Do not support	Do not support	Support	Do not support
Department of Treasury and Finance	Do not support	Do not support	Do not support	Do not support
Treasurer and Acting Minister for Finance	Do not support	Do not support	No direct feedback	No direct feedback
Malcolm Eastley	Does not support	Does not support	Does not support	Does not support
Caroline Larner	Does not support	Does not support	Requested more information	No direct feedback