

# 2018 Water and Sewerage Price Investigation

Response to the Tasmanian Economic Regulator's Draft Report



## Table of contents

<b>1</b>	<b>Introduction</b>	<b>3</b>
1.1	Structure of our response	3
<b>2</b>	<b>Weighted average cost of capital (WACC)</b>	<b>4</b>
2.1	Risk-free rate and debt risk premium	4
2.2	Gamma	9
2.3	Summary of our WACC response	10
<b>3</b>	<b>Regulatory depreciation</b>	<b>12</b>
3.1	Commentary on the calculation method for existing assets	12
3.2	Correction of an arithmetic error for depreciation of existing assets	14
3.3	Summary of our response to the TER's draft report on regulatory depreciation	14
<b>4</b>	<b>Operating expenditure</b>	<b>16</b>
4.1	Salaries	16
4.2	Materials and services	18
4.3	Chemicals	18
4.4	Motor vehicle costs	19
4.5	Productivity savings and operating expenditure arising from new capital expenditure	20
4.6	Summary of our response to the TER's draft report on regulated operating expenditure	24
<b>5</b>	<b>Capital expenditure</b>	<b>25</b>
5.1	Facilities, fleet and plant	25
5.2	Gifted assets	25
5.3	Summary of our response to the TER's draft report on capital expenditure	26
<b>6</b>	<b>Other matters in the TER's draft report</b>	<b>27</b>
6.1	Working capital allowance	27
6.2	Recognising assets on commissioning	29
6.3	Service replacement	29
6.4	Trade waste application fee	31
6.5	Labour force plan and asset rationalisation plan	31
6.6	Correction of items in our draft PSP3 submission	32
<b>7</b>	<b>Conclusion</b>	<b>33</b>
<b>Appendix 1:</b>	<b>Revised service replacement process</b>	<b>34</b>

## 1 Introduction

After evaluating our draft Price and Service Plan 3 (PSP3) submission, the Tasmanian Economic Regulator (TER) published its draft report on 30 November 2017 for public consultation. This document is our response to the TER's draft report.

We are pleased that the TER has accepted many of the proposals in our draft submission. Therefore, our response focuses only on the issues where we have a differing viewpoint. Our response focuses on areas where we believe the TER's proposals are:

- Based on inaccurate or incomplete data
- Based on a misunderstanding of TasWater's proposal, or
- Based on incorrect calculation methods.

Our response seeks to provide correct information for independent assessment by the TER in the development of its final report.

### 1.1 Structure of our response

Our response is grouped into the following sections:

- Weighted average cost of capital (WACC)
- Regulatory depreciation
- Operating expenditure
- Capital expenditure and
- Other matters in the TER's draft report.

We have engaged a third party to assess the technical merits of our proposed approach and the TER's proposed approach with respect to the WACC and regulatory depreciation. The timing of this review is such that we are unable to provide the assessment prior to the close of the public consultation period. We will forward the third party review as soon as possible.

## 2 Weighted average cost of capital (WACC)

The WACC is determined from a calculation based on a whole range of input parameters.

The discussion below relates only to the method used to determine the risk-free rate, debt risk premium and gamma. For all other parameters, we accept the approach outlined in the TER's draft report which generally accords with the approach we proposed in our draft PSP3 submission.

### 2.1 Risk-free rate and debt risk premium

Our proposed WACC calculation sought to align with regulatory precedent in other jurisdictions. In particular, we adopted a method consistent with that used by the Independent Pricing and Regulatory Tribunal (IPART) in New South Wales to determine the risk-free rate and debt risk premium. This method uses the mid-point of the 10-year and 40 trading day averages of Commonwealth Government bonds to reflect our underlying debt maturity profile.

The TER agreed that a mix of future and historical interest rates was appropriate given that a benchmark firm would have an efficient debt financing and risk management policy and such a policy would be based on issuing debt at different points in time with a staggered maturity profile.

However, the TER concluded that historical rates are over represented in the IPART approach that we adopted in our proposal. The TER argued that:

*businesses opportunistically restructure debt It therefore seems unlikely an efficiently managed business will have a fixed maturity and/or refinancing profile i.e. it will most likely have a mix of current and past interest rates and maturity profiles*

As a result, the TER has proposed an approach unique among Australian economic regulators that weights the 40 trading day average much more heavily than the 10-year average rate.

#### 2.1.1 Regulatory precedent

The TER frequently refers to three principles throughout the draft report, namely:

- Regulatory precedent – seeking to align with methods used by regulators in other jurisdictions in Australia for calculating the revenue building blocks
- Consistency over time – using the same approach across PSP periods to provide a stable, objective assessment method that can withstand short-term variation in data and
- Complexity and administrative burden – to the greatest extent possible, using simple and administratively efficient calculation methods.

In our view, the TER's proposed WACC method falls short on all three of these principles.

The TER noted a lack of regulatory consistency across Australia in the method for calculating the risk-free rate and debt risk premium. However, the TER has then added to that inconsistency in the draft determination by adopting an approach that is not used by any other regulator.

In general, the Australian Energy Regulator (AER), Essential Services Commission of Victoria (ESC) and Essential Services Commission of South Australia (ESCOSA) each use a simple 10-year trailing average of Commonwealth Government 10-year bonds to reflect the debt maturity profile of a regulated entity.

In contrast, the Queensland Competition Authority (QCA), Economic Regulation Authority of Western Australia (ERAWA) and the ACT's Independent Competition and Regulatory Commission (ICRC) each use an 'on the day' rate which reflects the most recent 40 trading day average for Commonwealth Government 10-year bond rates.

These two groups of regulators represent either end of the methodological spectrum for calculating the risk-free rate and debt risk premium. IPART takes the view that both current bond rates and historical bond rates are relevant to the calculation. This is because an efficient entity is likely to have a staggered debt maturity profile (ie both current and historical components), and because reference to only the current bond rates can create price volatility. As such, IPART uses the average of the 'on the day' rate and the 10-year average. We adopted the same method as IPART in our PSP3 submission.

The TER, on the other hand, has used a method that aligns neither with the 10-year trailing average (used by the AER, ESC and ESCOSA), the 'on the day' rate (used by the QCA, ERAWA and ICRC) nor with the mid-point (used by IPART and proposed by TasWater).

Instead, the TER has used a unique method that is somewhere between the mid-point and the 'on the day' rate. The TER's method uses a complicated time-weighted average of government bond rates and then averages this again with the 'on the day' rate. In rejecting our proposed methodology, the draft determination states that the TER considers historical rates are over represented in the IPART approach. However, the TER provides no substantiating evidence or regulatory economic theory to support this position or explain how the approach is superior to the method used by IPART or other regulators.

We note that IPART is currently undertaking a review of its WACC method<sup>1</sup> and has published an issues paper and draft report. IPART proposed to maintain its approach.<sup>2</sup> As IPART undertakes a comprehensive review of the WACC, we consider it appropriate to rely on IPART's findings for the risk-free rate and the debt risk premium.

Finally, while similar to the method used by the TER in PSP2, the TER's method for PSP3 is not exactly the same. Our understanding is that this approach could change yet again in PSP4 – leading to continued uncertainty for TasWater.

We acknowledge that regulatory precedent is inconsistent for the WACC. In such circumstances, regulatory certainty is not assisted by the introduction of a new approach that was not proposed by TasWater or stakeholders, is not used by any other regulator and is different to the TER's PSP2 approach.

### **2.1.2 Efficient debt raising**

A fundamental objective of economic regulation is to provide compensation for the efficient financing costs of the benchmark firm. A risk minimising firm would seek to adopt the same cost of debt as set by the regulator. To do otherwise would expose the firm to risk without compensation. It is therefore important that the regulator's cost of debt reflects an efficient cost and risk minimisation. Otherwise, the regulated firm would inefficiently raise debt.

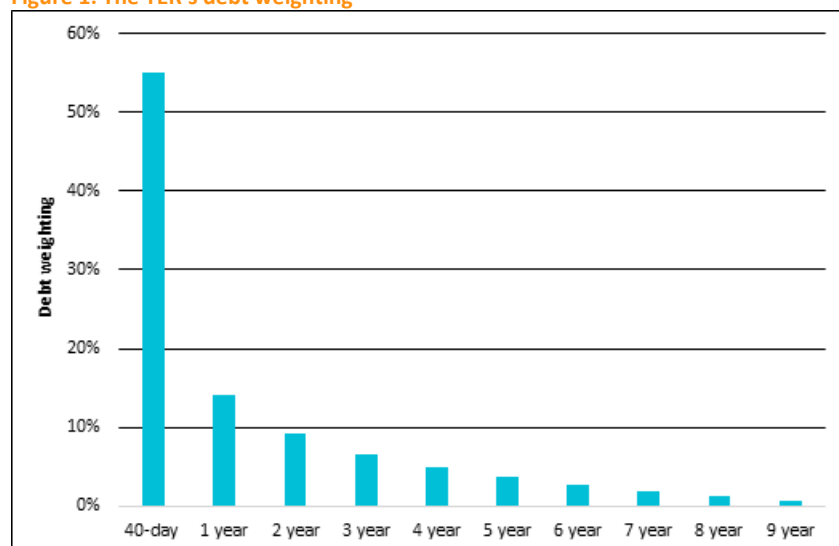
The method used by the TER in its draft report has a high weighting towards the present. Approximately 70 per cent of the weighting relates to the previous 12 months of bond rates. This does not reflect our approach to raising debt, nor does it reflect the approach that would be taken by a benchmark efficient entity.

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<sup>1</sup> IPART, Special reviews - WACC, 2017 - available at <https://www.ipart.nsw.gov.au/Home/Industries/Special-Reviews/Reviews/WACC/WACC-Methodology-2017?qDh=0>

<sup>2</sup> In the draft report, IPART proposed an adjustment for the difference between the on-the-day rates used to calculate the WACC and the actual rates experienced during the regulatory period. This approach is proposed in order to reduce re-financing risk. However, as this review is still in draft form, we do not propose a change.

Figure 1: The TER's debt weighting



The Queensland Treasury Corporation (QTC)<sup>3</sup> has set out the principles required for efficient debt raising. We consider these to be generally true for regulated entities including TasWater. These principles are set out in a recent QTC submission on the cost of debt to the QCA:<sup>4</sup>

- QTC considers maintaining a portfolio of debt with annually spaced maturity dates out to a sufficiently long maximum tenor to be an essential feature of a prudent and efficient strategy to manage refinancing risk
- As it is not possible for a levered firm to completely eliminate refinancing risk, it is important for the firm to stagger the maturity dates of its borrowings to keep exposure to adverse refinancing outcomes at a sufficiently low level
- A reasonable estimate of a firm's refinancing risk exposure is the percentage on total debt that matures each year, and in particular the percentage maturing within the next 12 months

Similarly, PwC recently reviewed the cost of capital for the QCA and found that:<sup>5</sup>

*From first principles we would expect that on average, a typical benchmark regulated business would issue debt for a period longer than the typical regulatory period of 5 years. A prudent debt manager would seek to issue debt that results in a relatively even and manageable debt refinancing task in each year.*

*Limiting the annual refinancing obligation reduces the exposure of the firm to unforeseen events in financial markets that may make refinancing difficult or excessively costly in the short term.*

*The annual refinancing task is directly dependent on the term of debt at issuance. For example, ignoring growth, if only ten-year term debt were to be issued and structured so the refinancing task is constant, then 10 per cent of the portfolio would need to be refinanced each year.*

<sup>3</sup> The QTC is the Queensland equivalent of the Tasmanian Public Finance Corporation (TASCORP).

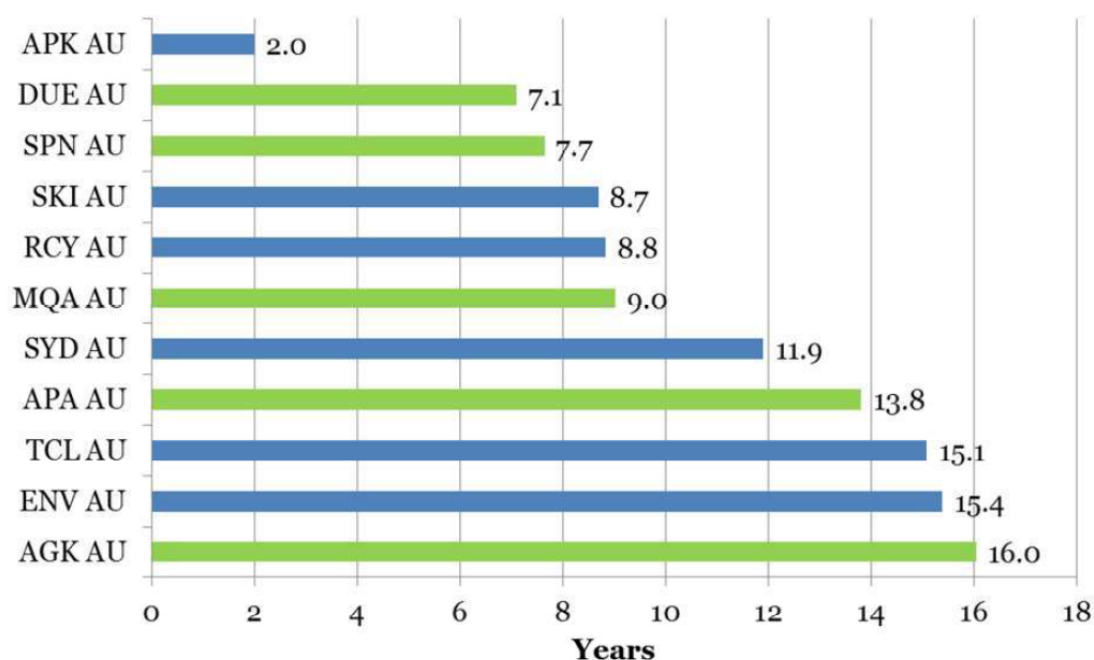
<sup>4</sup> Queensland Treasury Corporation, *Cost of debt submission to the Queensland Competition Authority*, 2014 - available at <http://www.qca.org.au/getattachment/ac2c7ea9-510d-4fe7-ac61-0dba60a4b47b/Queensland-Treasury-Corporation.aspx>

<sup>5</sup> PwC, *A cost of debt estimation methodology for businesses regulated by the Queensland Competition Authority*, 2013 - available at <http://www.qca.org.au/getattachment/66ead309-a5c4-4210-a1ac-bf8e98c57343/PwC-A-Cost-of-Debt-Estimation-Methodology-for-Busi.aspx>

PwC also identified five listed regulated gas and electricity businesses that were valid comparators for water corporations. The average term of debt at issuance for these businesses was 10.2 years.

In addition, a recent review of 13 private Australian infrastructure companies by the Competition Economists Group (CEG) shows that the average term of debt at issuance is 11.3 years.<sup>6</sup>

**Figure 2: Weighted average debt term at issuance for Australian companies**



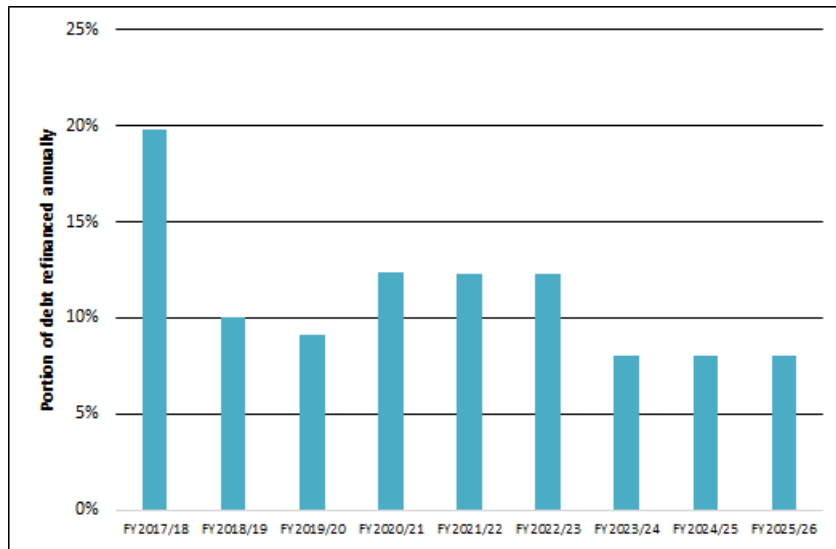
**Note:** this is a reproduction of Figure 3 from the CEG report (*Debt strategies of utility businesses*, 2013). Source: Bloomberg, CEG analysis.

We consider our debt profile to be consistent with the characteristics of a benchmark efficient entity identified above. Namely, approximately 10 per cent of our debt is refinanced each year as shown in the graph below.

<sup>6</sup> Competition Economists Group, *Debt strategies of utility businesses*, 2013 - available at <https://www.erawa.com.au/cproot/11661/2/Energy%20Networks%20Association%20-%20Draft%20Rate%20of%20Return%20Guidelines%20-%20Report%2017%20-%20Debt%20strategies%20report.pdf>



Figure 3: Portion of TasWater debt refinanced annually



The TER suggested we could opportunistically refinance debt. We understand this to mean that when the spot rate is below the average rate for the entire debt portfolio, we could close out some existing debt and purchase new debt at lower rates. The risks associated with this approach include:

- This approach can only be implemented when rates are falling (as is currently the case) but would be ineffective when rates are rising, which is half of the time. It is inappropriate to use a method that relies on a refinancing approach that can only be implemented half the time
- Closing out existing high cost debt and buying new low cost debt is not costless. The high cost debt needs to be sold at prevailing market rates
- Purchasing additional debt when rates are low (opportunistically, rather than as needed) will decrease the average borrowing rate, but may increase total borrowing costs. When debt is purchased before it is needed, interest needs to be paid. Also, it is possible that the cost of debt would be lower in the future when it is needed.

We contend that best practice debt raising requires debt to be raised as needed at the prevailing rates.

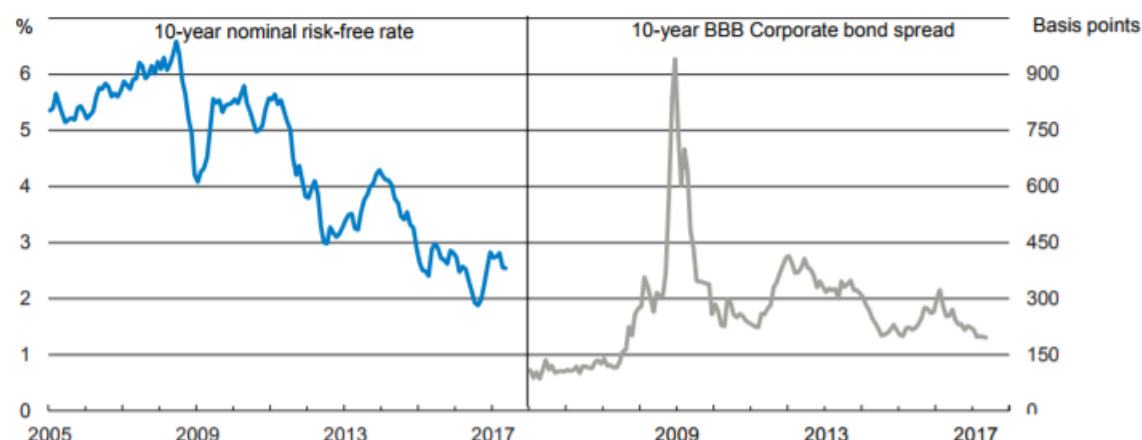
### 2.1.3 Price volatility

The cost of debt can fluctuate over time, even during short periods. When the cost of debt is heavily weighted toward spot rates, it increases the likelihood that the regulated cost of debt is set during a period of abnormal market conditions. Consequently, the WACC, and prices, could vary considerably between regulatory periods.

In its WACC review, IPART analysed the recent variation in the cost of debt. The following graph from IPART's Issues Paper shows the potential for significant variation.



Figure 4: Changes in cost of debt, 2005 to 2017



**Note:** this is a reproduction of Figure 4.1 from IPART (*Review of our WACC method, Issues Paper*, 2017). Data source: Bloomberg; RBA.

It is submitted that the TER's strong weighting toward the 'on the day' rate lays the foundation for greater price volatility for customers in the future relative to the method we have proposed.

#### 2.1.4 Our response to the TER's draft report on the risk-free rate and debt risk premium

For the reasons outlined above, the approach proposed by the TER to calculate the risk-free rate and the debt risk premium will either:

- Require us to significantly re-weight our debt portfolio every three years to ensure we are not exposed to interest rate risk. This is a deviation from best practice debt management and will likely lead to an overall increase in the cost of debt and/or refinancing risk, or
- Expose us to the risk that our actual cost of debt is materially different to our regulated cost of debt.

We note that interest rates are at historical lows and that it is likely that rates will be higher by PSP4. In that sense, a heavy weighting towards on the day could be beneficial for TasWater. However, we seek a WACC regime that can be consistently applied into the future.

Based on the evidence provided above and in our draft PSP3 submission, we continue to support our original proposal to calculate the risk-free rate and debt risk premium using a mid-point of the 10-year and 40 trading day averages of Commonwealth Government bonds.

## 2.2 Gamma

In our PSP3 submission, we proposed a gamma of zero on the basis that TasWater's owners, being local government authorities, were unable to benefit from dividend imputation credits by reducing their tax liabilities.

In its draft report, the TER determined that the shareholders in a benchmark efficient entity are private investors that could benefit from dividend imputation credits. Therefore, the TER proposed a gamma of 0.4.

The value of gamma impacts both the WACC and, more substantially, the tax allowance component of the revenue building blocks.

#### 2.2.1 Our response to the TER's draft report on gamma

TasWater's shareholders comprise 29 local government councils. The ownership of TasWater is restricted to local government councils as set out in Section 10 of the *Water and Sewerage Corporation Act 2012*. Moreover, all of the major political parties in Tasmania have stated policies committing to retaining TasWater in public ownership.

As 'end' shareholders, TasWater's owners cannot benefit from imputation credits. In this context, a revenue requirement (WACC and tax allowance) that is reduced to reflect the nature of imputation credits is inappropriate.

The TER argues that a benchmark efficient entity does not have shareholders that are councils, and relies upon a recent AER review that sets gamma equal to 0.4. In its review, the AER found:

*Our conceptual approach considers the value of gamma as a post (company) tax value before the impact of personal taxes and personal costs. This is because we use a post-tax revenue model for revenue regulation for each regulated entity. The value of gamma has to be understood, and consistently estimated and applied, in that overall context.*

Note: underlined emphasis added.

The AER also found that:

*We consider the utilisation value reflects the weighted average, by wealth and risk aversion, of the utilisation rates of investors—some of whom will have a utilisation rate of 1 and others who will have a utilisation rate of 0.*

In our case, the context is clear and the investors are known. Our shareholders are councils, not people. Our shareholders have a utilisation rate of zero and therefore should have a gamma of zero.

The TER's view also implicitly suggests that economic regulators have the discretion to decide what the ownership structure of regulated firms should be. By this, we mean that economic regulators can effectively dictate whether a firm should be owned by domestic shareholders (individuals, companies or councils), foreign shareholders (individuals, companies or councils), or other entities. We do not consider such discretion exists – nor would it be appropriate.

We consider a key goal of economic regulators is to promote efficient outcomes in markets, not dictate ownership structures for regulated firms.

In contrast, referring to a benchmark efficient entity to derive WACC components like the gearing ratio and cost of debt is reasonable. This is because a regulated entity could game the process if firm-specific parameters (or actuals) were being adopted to determine the WACC. For example, a regulated firm could lower its gearing ratio to increase its share of equity, which could lead to a higher WACC. We accept that gaming of this nature should be discouraged by the regulator (and the TER does so appropriately). However, in our view applying the benchmark efficient entity concept to the determination of ownership for a regulated utility demonstrates a degree of regulatory overreach.

We continue to believe that our position in the draft PSP3 submission for setting gamma equal to zero is appropriate. TasWater is owned by 29 local government councils and will continue to remain in public ownership indefinitely. That is, TasWater's shareholders are unable to benefit from imputation credits and we consider it unreasonable to reduce their taxation allowance to reflect a benefit they cannot receive.

## 2.3 Summary of our WACC response

As stated above, we submit that the original proposals in our draft PSP3 submission with respect to calculating the risk-free rate and debt risk premium, and for determining the value of gamma, are appropriate. Our calculation of the WACC parameters is summarised in the table below, noting that some parameters have been updated to reflect bond market data as at 29 December 2017.

**Table 1: Weighted average cost of capital parameters**

WACC parameter	TasWater (draft PSP3 submission)	TER (draft report)	TasWater (response to TER)	Reason for change
Gearing	60%	60%	60%	
Risk-free rate	3.50%	2.90%	3.26%	Updated market data
Debt risk premium	2.49%	2.03%	2.35%	Updated market data
Debt issuance	0.10%	0.10%	0.10%	
Cost of debt (pre-tax)	6.09%	5.02%	5.71%	Calculated parameter
Market risk premium	6.50%	6.50%	6.50%	
Equity beta	0.70	0.65	0.65	Accept TER draft
Statutory return on equity (existing) (pre-tax nominal)	3.00%	3.00%	3.00%	
Gamma	0	0.4	0	
Cost of equity <sub>(new)</sub> (post-tax)	8.05%	7.12%	7.49%	Calculated parameter
<b>WACC<sub>existing</sub></b>	<b>4.49%</b>	<b>4.00%</b>	<b>4.27%</b>	<b>Calculated parameter</b>
<b>WACC<sub>new</sub></b>	<b>6.87%</b>	<b>5.86%</b>	<b>6.42%</b>	<b>Calculated parameter</b>

The impact of our revised WACC parameters on the return on capital and taxation allowance components of our revenue building blocks are shown in the tables below.

**Table 2: Response to the TER's draft report on total return on capital (\$'000s)**

Total return on capital	FY2018/19	FY2019/20	FY2020/21	PSP3 Total
TasWater proposed return on capital (draft PSP3 submission)	157,908	165,021	171,852	494,782
TER proposed return on capital (draft report)	143,884	150,154	157,380	451,418
TasWater revised return on capital (response to TER report)	154,832	162,431	171,057	488,320
Difference between our draft PSP3 submission and our revised proposal	-3,076	-2,590	-795	-6,462

**Table 3: Response to the TER's draft report on taxation allowance (\$'000s)**

Taxation allowance	FY2018/19	FY2019/20	FY2020/21	PSP3 Total
TasWater proposed taxation allowance (draft PSP3 submission)	22,021	23,514	24,954	70,489
TER proposed taxation allowance (draft report)	10,781	11,546	12,430	34,757
TasWater revised taxation allowance (response to TER report)	18,514	20,067	21,816	60,397
Difference between our draft PSP3 submission and our revised proposal	-3,507	-3,448	-3,138	-10,093

Note: while we have maintained a gamma of zero, our tax allowance is now less than our original proposal. This is due to other parameters in the calculation such as our RAB (which is lower due to a different approach to depreciation for existing assets, among other factors).

### 3 Regulatory depreciation

Our draft PSP3 submission was based on a 'line by line' calculation of regulatory depreciation for both existing assets (those transferred before 1 July 2011) and new assets (those purchased or constructed since 1 July 2009). The line by line approach divides the remaining asset value by the remaining asset life for each asset in our asset register.

In its draft report, TER has adopted a hybrid approach to calculate regulatory depreciation. The hybrid approach uses our proposed line by line method for new assets, but uses an average expected life method for existing assets (the same approach used for all assets in PSP2). Our response is provided in two parts:

- Commentary on the calculation method for depreciation of existing assets
- A request for correction of an arithmetic error on the TER's application of the weighted average useful life method

#### 3.1 Commentary on the calculation method for existing assets

Although the TER accepted our proposal to calculate depreciation for new assets using a line by line approach, the TER cited numerous reasons for not accepting this same approach for existing assets.

We maintain that our original proposal is the most accurate method to determine remaining asset lives as noted by the AER.<sup>7</sup> However, we acknowledge that the TER's method has been used by other regulators in Australia.

As such, we have completed our revised price modelling for PSP3 using the TER's preferred hybrid method (but incorporating an arithmetic correction described in section 3.2). Nonetheless, we provide commentary below on the TER's rationale for using the weighted average useful life method for existing assets for consideration.

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<sup>7</sup> Australian Energy Regulator, *Preliminary Decision - SA Power Networks determination 2015-16 to 2019-20*, Attachment 5, April 2015

**Table 4: Commentary on the TER's draft conclusions for the calculation of depreciation for existing assets**

Issue	TER draft conclusion	TasWater comments
Regulatory precedent	<p>The TER concludes that there is no consistent approach to regulatory depreciation between regulators.</p> <p>The TER also believes TasWater's reliance on the AER report is not valid given that "the AER specifically states that its year-by-year tracking methodology does not involve tracking the depreciation on individual assets."</p>	<p>We agree that regulatory precedent is inconsistent. However, we maintain that when data is available and administrative burden is low, our line by line method represents the most accurate approach as referenced by the AER.</p> <p>We also firmly stand behind the validity of the AER report as it applies to our proposal. While SA Power Networks was not proposing to track individual assets in practice, the AER report clearly and unequivocally states on page 5-12 "The most accurate way of estimating remaining asset lives is to track every asset individually." The AER does raise concerns about the potential administrative cost of doing so, which we address below.</p>
Intergenerational equity	<p>The TER cites an ESC (Victoria) analysis showing the impact on businesses is neutral with respect to a line by line approach or weighted average approach.</p> <p>Further, the TER suggests it is also possible future customers could benefit relative to current customers using the line by line approach</p>	<p>We agree that the relativity in the chosen depreciation method can be NPV neutral over time. However, the chosen method does have an impact on the timing of revenue cash flow for the regulated entity. To that end, the TER's chosen method is inconsistent with the funding assumptions that underpin our Long Term Strategic Plan.</p> <p>Also, the TER has provided no evidence regarding intergenerational equity. We have provided data demonstrating the TER's weighted average useful life approach benefits current customers over future customers relative to the line by line approach. The line by line approach inherently ensures future customers do not benefit relative to current ones. Customers in any given year contribute equitably to returning the capital they consume.</p>
Administrative burden	<p>The TER concludes that applying a line by line approach to 260,000 assets would be complex and comes with substantial administrative costs both for TasWater and the TER</p>	<p>260,000 data points is very small relative to the computing and analytical power that is readily available. We have offered to provide OTTER with auditing access to our software system that enables this. Relatively inexpensive data solutions and expertise to calculate and track line by line depreciation data over time are commonly available and therefore this does not represent a legitimate justification for not using a line by line depreciation methodology.</p>
Consistency over time	<p>The TER considers it best practice to maintain calculation methods for regulatory depreciation over time</p>	<p>We agree that it is important to maintain consistency over time for the calculation of depreciation, the WACC and other aspects of the building blocks. However, in this case we believe the magnitude of improvement warrants a one-off change in method that will benefit customers. We have also demonstrated, using our asset data, that the resulting depreciation profile is relatively smooth over time mitigating any concerns about price volatility.</p>
Data accuracy	<p>The TER cites concerns with respect to the veracity of data in our asset register, particularly with respect to the condition of the assets</p>	<p>Detailed condition assessments were not comprehensively completed as part of the GHD/Deloitte valuation in 2009. This is consistent with best practice valuation exercises completed elsewhere in Australia (eg, the 2011 financial valuation of 15 Victorian water corporations by the Valuer General Victoria).</p> <p>Instead, proven statistical and engineering techniques were used to extrapolate condition assessments completed for a sample of assets to the broader asset base. Engineering knowledge of deterioration rates for specific asset types and materials, adjusted for environmental conditions, are well established and have not changed materially over time (ie, since the 2009 GHD valuation for TasWater). No asset owner in Australia undertakes condition assessment of every one of its assets – doing so would be inefficient.</p> <p>That is, the accuracy of data in TasWater's asset register with respect to useful lives – and remaining useful lives – is consistent with best practice. The TER has not pointed to any specific examples of data inaccuracy in the draft report. We believe it is better to identify and fix inaccurate data rather than depart from the best practice method altogether.</p> <p>Further, if data inaccuracy exists then averaging is not a statistically valid solution to this problem. An average can only correct for error if a symmetric (normal) error distribution exists in the asset values and useful lives. In practice, any errors are likely to stem from an engineering bias in one direction or another and would not be normally distributed. In this case, using an average reinforces the error rather than corrects for it.</p>
Gifted assets	<p>The TER notes that some existing assets were gifted to councils by developers and the State Government.</p>	<p>By legislation, TasWater is restricted to a pre-tax <u>return on</u> equity on existing assets of three per cent. This legislation was enacted to recognise that some assets transferred to TasWater were gifted by developers or government.</p> <p>However, the legislation does not limit TasWater's <u>return of</u> these assets. In our view, this is not a valid reason to reduce our depreciation allowance.</p>

### 3.2 Correction of an arithmetic error for depreciation of existing assets

In its draft report, the TER reduced our depreciation of existing assets by a total of \$69 million over PSP3 based on using a weighted average useful life depreciation method instead of our proposed line by line method. The impact is detailed in the table below.

**Table 5: Proposed depreciation for existing assets in PSP3 (\$'000s)**

Depreciation	FY2018/19	FY2019/20	FY2020/21	PSP3 Total
TasWater proposed depreciation (draft PSP3 submission)	72,929	72,889	72,690	218,509
TER proposed depreciation (draft report)	49,969	49,801	49,642	148,692
Difference	-22,960	-23,088	-23,048	-69,097

#### 3.2.1 Our response to the TER's draft report on depreciation of existing assets

Notwithstanding our views on the logic of using line by line depreciation as set out above, we have for the purpose of our revised price model remodelled asset depreciation using the TER's weighted average useful life methodology proposed in its preliminary determination as shown in the table below.

**Table 6: Calculation of existing asset depreciation using the weighted average useful life method**

Parameter	FY2018/19	FY2019/20	FY2020/21	PSP3 Total
Indexed existing asset replacement value (\$'000s)	2,960,231	3,003,842	3,055,783	n/a
Average useful life (years)	51	52	52	n/a
Depreciation rate (%)	1.95%	1.94%	1.93%	n/a
Depreciation amount (\$'000s)	57,707	58,202	58,856	174,766
Disposal depreciation (\$'000s)	2	18	0	20
<b>Total existing asset depreciation amount (\$'000s)</b>	<b>57,710</b>	<b>58,220</b>	<b>58,856</b>	<b>174,786</b>

The depreciation amount in this table is calculated by dividing the asset replacement value (undepreciated) by the average useful life (full life, not remaining life).

In its draft report, the TER applied the weighted average depreciation rate we provided (1.93% to 1.95%) to a depreciated remaining asset value. To be arithmetically correct, this depreciation rate should have been applied to the undepreciated replacement asset value (the 'indexed existing asset replacement value' in the table above). We believe this correction should be made in the TER's final report.

### 3.3 Summary of our response to the TER's draft report on regulatory depreciation

In the event that the TER decides irrespective of our arguments for the use of a line by line methodology to continue with the use of a weighted average useful life methodology for existing assets, we believe the TER's total depreciation amount should be updated to reflect:

- A correction of the arithmetic error for existing assets described in section 3.2.1
- Reinstatement of our full capex amount (\$467 million over PSP3) for calculating new asset depreciation to take into account the updates to gifted assets and fleet capex described in section 5.1 and 5.2.

Our revised depreciation amount in response to the TER's draft report is summarised in the table below.

**Table 7: Response to the TER's draft report on regulatory depreciation (\$'000s)**

Regulatory depreciation	FY2018/19	FY2019/20	FY2020/21	PSP3 Total
<b>TasWater proposed depreciation (draft PSP3 submission)</b>				
Existing assets	72,929	72,889	72,690	218,509
New assets	37,038	42,017	47,169	126,223
Total	109,967	114,906	119,859	344,732
<b>TER proposed depreciation (draft report)</b>				
Existing assets	49,969	49,801	49,642	148,692
New assets	36,737	41,311	46,131	124,179
Total	86,706	91,112	95,773	272,871
<b>TasWater revised depreciation (response to TER report)</b>				
Existing assets*	57,710	58,210	58,856	174,779
New assets	37,038	42,017	47,169	126,223
Total	94,752	100,227	106,024	301,003
<b>Difference between our draft PSP3 submission and our revised proposal</b>				
Existing assets	-15,215	-14,680	-13,834	-43,730
New assets	0	0	0	0
Total	-15,215	-14,680	-13,834	-43,730

\*Note: the revised existing asset depreciation in the table above is slightly lower than the value in Table 6 due to the way the values are included in the full pricing model. The difference is immaterial (approximately \$6,000 over the PSP3 period).



## 4 Operating expenditure

In its draft report, the TER proposed to reduce our operating expenditure (opex) by approximately \$16.9 million in total over the PSP3 period compared to our draft PSP3 submission. The reductions were based on the TER's own analysis of our opex as well as advice received from an external consultant, Arup, who conducted a review of our opex and capital expenditure (capex). The TER's proposed opex reductions are due to three factors:

- The TER has used a lower escalation rate than TasWater for salaries, materials and services, and chemicals opex
- The TER has reduced opex for motor vehicles to reflect what they perceive to be an efficient fleet size and
- The TER proposes that we absorb the additional operating costs that arise from our new capital expenditure as an efficiency adjustment (eg new/upgraded treatment plants).

The proposed reductions are summarised in the table below.

**Table 8: Total regulated opex for PSP3 (\$'000s)**

Proposal	FY2018/19	FY2019/20	FY2020/21	PSP3 Total
TasWater proposed opex (draft PSP3 submission)	174,781	178,691	185,260	538,732
TER proposed direct cost reductions	-3,412	-3,372	-3,693	-10,477
TER proposed efficiency adjustment	-1,507	-2,170	-2,720	-6,397
TER proposed opex (draft report)	169,862	173,149	178,847	521,858

Since publication of the TER's draft report, Arup has revised its draft report to correct arithmetic errors. This has resulted in a slightly smaller cost reduction overall of \$15.4 million as shown in the table below.

**Table 9: Total regulated opex for PSP3 – updated based on revised Arup figures (\$'000s)**

Proposal	FY2018/19	FY2019/20	FY2020/21	PSP3 Total
TasWater proposed opex (draft PSP3 submission)	174,781	178,691	185,260	538,732
TER proposed direct cost reductions (revised by Arup)	-1,854	-2,846	-4,341	-9,041
TER proposed efficiency adjustment	-1,507	-2,170	-2,720	-6,397
TER proposed opex (draft report, revised by Arup)	171,420	173,675	178,199	523,294

### 4.1 Salaries

In its draft report, the TER proposed to escalate our salary costs in PSP3 by two per cent per annum, rather than the 2.25 per cent in our draft submission. The TER's proposal of two per cent escalation would mirror the annual fixed wage increase in our current General Enterprise Agreements (EA) with employees.

Arup noted that, although the current General EAs are due to expire at the end of PSP2, analysis done by Deloitte Access Economics forecasts that utility labour prices will continue to increase by about two per cent per annum during the PSP3 period. This resulted in a total reduction of \$0.4 million over PSP3 for salaries opex as shown in the table below.

**Table 10: Proposed regulated salaries opex for PSP3 (\$'000s)**

Salaries	FY2018/19	FY2019/20	FY2020/21	PSP3 Total
TasWater proposed opex (draft PSP3 submission) <sup>8</sup>	82,552	84,273	86,279	253,104
TER proposed opex (draft report, revised by Arup)	82,574	84,137	85,959	252,670
Difference	22	-136	-320	-434

Since our draft PSP3 submission in June 2017, negotiations with our senior employees on a new EA have continued to progress. The existing Senior EA expired on 1 July 2017 and covers approximately 118 staff members, while the current General EAs (covering most other non-senior staff) expires on 1 July 2018. A proposed new Senior EA that included a 2.3 per cent annual salary increase was put to staff by ballot in December 2017 but was not supported. We continue negotiations with our senior staff members for a new EA covering the period from 1 July 2017 to 1 July 2019.

Also, the TER's draft report was based on a version of the Deloitte Access Economics report that was published in 2015. We note that Deloitte Access Economics provided an updated report in 2017<sup>9</sup> which concludes:

*We expect the five-year average for wage growth in the Tasmanian utilities sector to reach around 3.3% by 2018-19.*

Similarly, the Australian Government's Mid-Year Economic and Fiscal Outlook (MYEFO)<sup>10</sup> forecasts that wage growth will accelerate to 3.5 per cent by FY2020/21.

We consider that it is appropriate to forecast wage increases consistent with the EA. Given that our forecast EA increases are substantially less than other forecasts (e.g. Deloitte, Australian Government), we consider that an annual labour escalation rate of 2.25 per cent in PSP3 is reasonable and that an increase of two per cent is unrealistic.

#### 4.1.1 Our revised salaries opex in response to the TER's draft report

As per our draft PSP3 submission, we maintain that salaries opex should be escalated at 2.25 per cent per annum. We note that our draft PSP3 pricing model erroneously contained an escalation factor of 2.2 per cent rather than our intended 2.25 per cent. Our proposed salaries opex for PSP3 is shown in the table below and corrects for this error.

**Table 11: Response to the TER's draft report on regulated salaries opex (\$'000s)**

Salaries	FY2018/19	FY2019/20	FY2020/21	PSP3 Total
TasWater proposed opex (draft PSP3 submission)	82,552	84,273	86,279	253,104
TER proposed opex (draft report, revised by Arup)	82,574	84,137	85,959	252,670
TasWater revised opex (response to TER report)	82,592	84,355	86,406	253,353
Difference between our draft PSP3 submission and our revised proposal	40	82	127	249

<sup>8</sup> Our proposed opex shown in Chapter 7 of the TER's draft report does not match the proposed opex in our draft submission and pricing model. The figures listed here align with those included in our draft submission and pricing model rather than the TER's draft report. This also applies to the other opex categories discussed below.

<sup>9</sup> Deloitte Access Economics, *Labour Price Forecasts Prepared for the Australian Energy Regulator*, 2017 – available at [https://www.aer.gov.au/system/files/Deloitte%20Access%20Economics%20-%20Labour%20Price%20Forecasts%20-%206%20February%202017\\_3.PDF](https://www.aer.gov.au/system/files/Deloitte%20Access%20Economics%20-%20Labour%20Price%20Forecasts%20-%206%20February%202017_3.PDF)

<sup>10</sup> Commonwealth of Australia, *Mid-Year Economic and Fiscal Outlook 2017-18*, 2017 – available at [http://www.budget.gov.au/2017-18/content/myefo/download/MYEFO\\_2017-18.pdf](http://www.budget.gov.au/2017-18/content/myefo/download/MYEFO_2017-18.pdf)

## 4.2 Materials and services

The TER proposed to escalate our materials and services costs by three per cent per annum, rather than the average annual increase of 5.3 per cent during PSP3 in our draft submission. This resulted in a total reduction of \$3.9 million over PSP3 for materials and services opex as shown in the table below.

**Table 12: Proposed regulated materials and services opex for PSP3 (\$'000s)**

Materials and services	FY2018/19	FY2019/20	FY2020/21	PSP3 Total
TasWater proposed opex (draft PSP3 submission)	28,865	30,258	32,108	91,231
TER proposed opex (draft report, revised by Arup)	28,133	29,098	30,093	87,324
Difference	-732	-1,160	-2,015	-3,907

### 4.2.1 Our revised materials and services opex in response to the TER's draft report

Materials and services opex has many components and naturally attracts a wide range of estimates for forecast escalation. While we believe our original escalation rate is appropriate, we agree that a three per cent escalation is within a reasonable range. As such, we are prepared to accept the TER's proposed escalation rate of three per cent per annum for materials and services opex. The table below summarises our materials and services opex proposal.

**Table 13: Response to the TER's draft report on regulated materials and services opex (\$'000s)**

Materials and services	FY2018/19	FY2019/20	FY2020/21	PSP3 Total
TasWater proposed opex (draft PSP3 submission)	28,865	30,258	32,108	91,231
TER proposed opex (draft report, revised by Arup)	28,133	29,098	30,093	87,324
TasWater revised opex (response to TER report)	28,079	29,046	30,046	87,171
Difference between our draft PSP3 submission and our revised proposal	-786	-1,212	-2,062	-4,060

We note that our revised opex estimate is slightly different than the TER's proposed opex for materials and services. We believe this is due at least in part to the level of precision in our pricing model relative to Arup's model. For example, our pricing model allocates 95.87% of total opex to regulated activities while Arup's model rounds this figure to 96%.

## 4.3 Chemicals

The TER proposed to escalate our chemical costs by 1.5 per cent per annum in PSP3, rather than the 5.02 per cent increase in our draft submission. The TER's proposal was based on guidance from Arup that a historical five-year average of chemical prices was a more appropriate basis for forecasting than the 10-year average used in our draft submission. This resulted in a total reduction of \$2.1 million over PSP3 for chemicals opex as shown in the table below.

**Table 14: Proposed regulated chemicals opex for PSP3 (\$'000s)**

Chemicals	FY2018/19	FY2019/20	FY2020/21	PSP3 Total
TasWater proposed opex (draft PSP3 submission)	9,726	10,274	10,853	30,853
TER proposed opex (draft report, revised by Arup)	9,389	9,580	9,774	28,743
Difference	-337	-694	-1,079	-2,110

#### 4.3.1 Our revised chemicals opex in response to the TER's draft report

The 10-year average for chemical prices in our draft submission included a period of high volatility where prices rose dramatically in late 2008 and early 2009. Although commodities such as chemicals are prone to periodic volatility due to both cyclical and seasonal factors, we agree that a five-year historical average is a reasonable basis for escalating chemicals opex in PSP3.

However, we note that the actual historical five-year average for chemicals prices results in a 1.97 per cent escalation rate based on Australian Bureau of Statistics (ABS) data series A3343855L. We understand that Arup's guidance of 1.5 per cent was an approximation derived from a graph of the ABS data we provided rather than the data source itself.

Therefore, we accept the TER's proposal to use a historical five-year average and we propose an annual escalation rate for chemicals opex in PSP3 of 1.97 per cent based on the ABS data. Our revised chemicals opex proposal is shown in the table below.

**Table 15: Response to the TER's draft report on regulated chemicals opex (\$'000s)**

Chemicals	FY2018/19	FY2019/20	FY2020/21	PSP3 Total
TasWater proposed opex (draft PSP3 submission)	9,726	10,274	10,853	30,853
TER proposed opex (draft report, revised by Arup)	9,389	9,580	9,774	28,743
TasWater revised opex (response to TER report)	9,444	9,686	9,934	29,064
Difference between our draft PSP3 submission and our revised proposal	-282	-588	-919	-1,789

#### 4.4 Motor vehicle costs

The TER proposed to reduce our motor vehicle opex by \$1.7 million in total over PSP3 based on guidance from Arup that our vehicle to staff ratio should be lower to reflect an efficient level. Arup found that our current vehicle to staff ratio was 1:1.2 and they recommended it should be reduced to 1:2 in PSP3. The reduction in our motor vehicle opex is detailed in the table below.

**Table 16: Proposed motor vehicles opex for PSP3 (\$'000s)**

Motor vehicles	FY2018/19	FY2019/20	FY2020/21	PSP3 Total
TasWater proposed opex (draft PSP3 submission)	3,959	3,989	4,019	11,966
TER proposed opex (draft report, revised by Arup)	3,389	3,414	3,440	10,243
Difference	-570	-574	-579	-1,723

#### 4.4.1 Our revised motor vehicles opex in response to the TER's draft report

The vehicle to staff ratio calculated by Arup (1:1.2) was based on TasWater having 760 vehicles – a figure provided to Arup by us. However, this figure was incorrect and actually represented the number of assets in our fleet (where assets include not only vehicles but also trailers, backhoes, forklifts, excavators and other mobile equipment) rather than the number of vehicles in our fleet.

As at December 2017, we currently have 751 assets in our fleet – of which 458 are vehicles – as shown in the table below.<sup>11</sup>

<sup>11</sup> We can provide a spreadsheet of our fleet asset register upon request.

**Table 17: Fleet assets as at December 2017**

Asset type	Number
Vehicles	458
<i>Cars and vans</i>	105
<i>Utes</i>	255
<i>Trucks</i>	98
Trailers	127
Mobile plant	99
Excavators	31
Forklifts	24
Backhoes	7
Front end loaders	5
<b>Total</b>	<b>751</b>

Based on this data, our vehicle to staff ratio is currently 1:2 which is the PSP3 target recommended by Arup. Consequently we do not consider it necessary to reduce our motor vehicle opex forecast.

**Table 18: Response to the TER's draft report on motor vehicles opex (\$'000s)**

Motor vehicles	FY2018/19	FY2019/20	FY2020/21	PSP3 Total
TasWater proposed opex (draft PSP3 submission)	3,959	3,989	4,019	11,966
TER proposed opex (draft report, revised by Arup)	3,389	3,414	3,440	10,243
TasWater revised opex (response to TER report)	3,959	3,989	4,019	11,966
Difference between our draft PSP3 submission and our revised proposal	0	0	0	0

#### 4.5 Productivity savings and operating expenditure arising from new capital expenditure

In its draft report, the TER proposed not to allow us to recover the additional opex costs associated with new capex that is needed to increase compliance levels. This is a departure from the TER's method in PSP2 which included benchmarking of our overall operational efficiency and explicitly allowed operating expenditure arising from new capital expenditure. The TER relied on Arup's report to reach the new position in its draft PSP3 report, specifically:

*..... [it] would expect that consecutive regulatory years of opex overspend are reflected in improved compliance and benchmarked performance by the end of PSP2, and going forward, the spending levels must be rigidly maintained within the final regulated allowance in PSP3. Should this not occur during PSP3, the TER would likely be justified in imposing significant sanctions for non-compliance by TasWater.*

On the basis of this, the TER concluded:

*The Economic Regulator shares Arup's concerns about TasWater's productivity savings falling away over the third regulatory period*

As a result, the TER proposed to require us to achieve additional productivity savings equal to our forecast of the impact of new capex on opex.<sup>12</sup>

<sup>12</sup> The TER also notes that it "...remains mindful of the fact that, under a building block approach, it is unable to clawback opex that is subsequently found to be inefficient". This is a one-sided argument. It is also true that we cannot recover revenue for higher than expected

#### 4.5.1 Our response to the TER's draft report on productivity savings

We accept the need for ongoing productivity improvements, which is why we forecast to permanently decrease opex by \$12 million per annum by the end of PSP3. We have structured our productivity program to reduce costs as much as possible, as soon as practicable. Consequently, productivity improvements start high and taper off.

In our view, the issue of productivity should be assessed as a stand-alone issue. It is not appropriate to simply disallow an entire cost category (i.e. opex arising from new capex) in lieu of productivity savings.

For example, when considering whether to undertake a new project, we select the best option by taking into account both opex and capex costs. The least cost overall option is selected. If new opex is disallowed, the regulatory environment provides an incentive for us to undertake projects that have minimal new opex, even if they are not the least cost overall.

Arup, on behalf of the TER, has completed an independent assessment of our proposed capex for PSP3. In general, Arup found our proposed capex to be prudent and efficient and the TER has agreed with Arup's assessment. This assessment included ensuring that the least cost option has been chosen. The TER's subsequent proposal to disallow opex arising from new capex is inconsistent with the TER's own proposal to largely accept the prudence and efficiency of our PSP3 capex plan.

It is also unclear whether the TER intends to apply this method in future regulatory determinations. The investment required to meet our customer outcome commitments over the long term has a natural and unavoidable consequence of increasing our opex to some extent. The TER's approach in PSP3 is clearly unsustainable if it is to be applied in PSP4, PSP5 and beyond.

Further, the opex reduction chosen by the TER is arbitrary and without any accompanying analysis or evidence. While productivity measures are appropriate, the TER has an obligation to allow us to recover our prudent and efficient costs. The TER's draft report contains no suggestion that the specific costs that have been disallowed (i.e. opex arising from new capex) are not prudent or efficient. There is also no analysis to suggest that this additional opex reduction can be implemented without a reduction in service standards.

Arup also completed an independent assessment of the prudence and efficiency of our proposed opex for PSP3. Arup recommended total opex reductions of approximately 0.1% per annum – most of which relate to a different view regarding future escalation rates. We acknowledge that future escalation rates are uncertain and we have accepted many of Arup's recommendations as described in the sections above. As part of the opex assessment, Arup reviewed our proposed productivity savings and concluded that:

*TasWater has identified the bulk of productivity savings to occur within the next two financial years, with minimal savings thereafter. Arup would encourage TasWater to revisit their forecasts throughout this period as advancements in technology and processes adopted by their benchmarked peers allow for further scope in opex optimisations in the last two years of PSP3.*

Nonetheless, Arup did not recommend a further reduction in opex to account for greater productivity improvements. That is, the TER's proposal to require additional productivity savings by disallowing opex arising from new capex is not supported by any calculations in Arup's assessment.

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efficient opex (ie, in response to a storm, prolonged weather patterns, emergence of algal blooms). The TER has not presented any evidence to demonstrate there is an asymmetric risk that requires a bias toward a lower opex figure.

We agree with Arup that productivity savings should be continually reviewed. However, we do not consider that the TER's interpretation of Arup's conclusion is accurate. In our view, Arup's report recommends that we constrain our spending within the PSP3 allowance, noting that this has not previously been the case. For this to occur, it is essential that any reductions imposed by the TER reflect realistic and achievable targets, not an arbitrary reduction.

We note that a recent opex benchmarking study undertaken by consulting firm Third Horizon on behalf of the Water Services Association of Australia (WSAA) showed some areas where our effective cost to serve customers is higher than our similarly sized counterparts.<sup>13</sup> In many cases, this is driven by the population dispersion and geography of Tasmania which requires us to operate and maintain more assets than our comparable peers.

However, when adjusted for economies of scale our average water treatment plant and sewage treatment plant operating costs are lower than the participants in the WSAA benchmarking study as shown in the graphs below.

Figure 5: Benchmarking of sewage treatment plant opex adjusted for scale

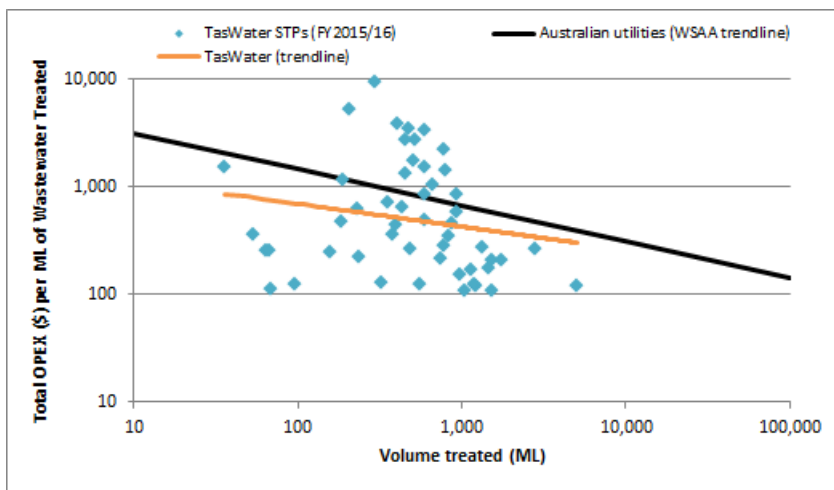
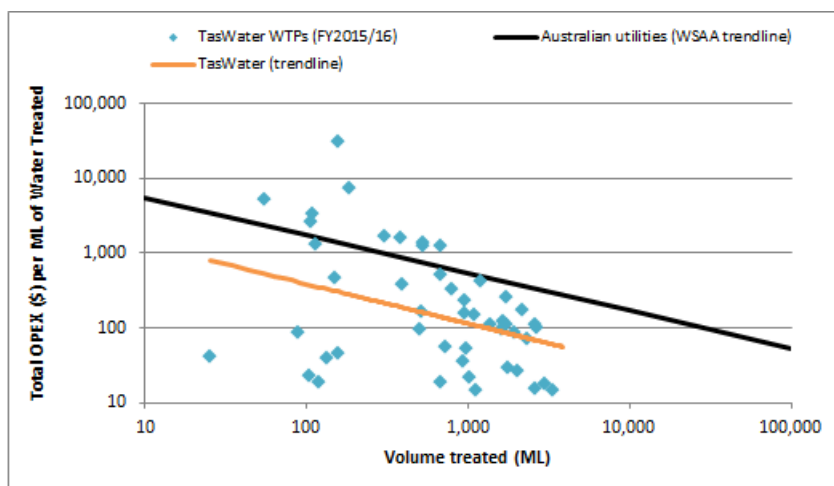


Figure 6: Benchmarking of water treatment plant opex adjusted for scale

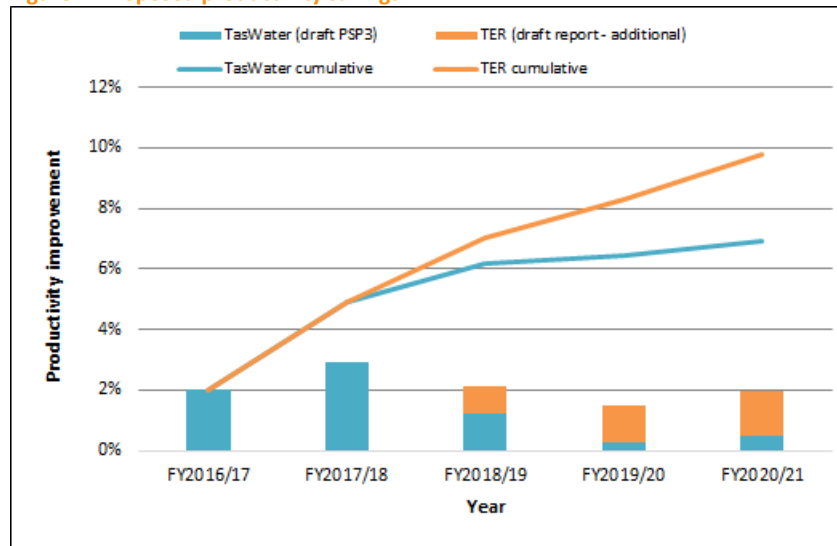


<sup>13</sup> Third Horizon and Water Services Association of Australia, *TasWater Opex Benchmarking 2014/15 – Final Participant Report*, December 2015



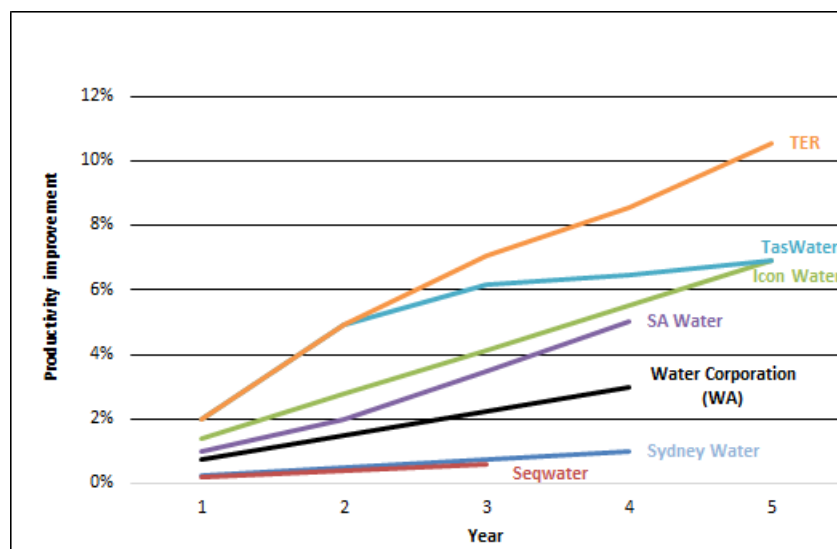
Nonetheless, we recognise that minimising price increases is a high priority for our customers. As a result, we initiated our Productivity Improvement Program to identify efficiencies and achieve permanent cost savings of \$12 million per annum by the end of PSP3. This amounts to a cumulative opex reduction of seven per cent over five years. The addition of the TER's productivity savings increases the cumulative opex reduction to 9.8 per cent with no substantive basis for the further reduction.

Figure 7: Proposed productivity savings



We have compared our proposed productivity improvements with other regulated entities and have found that our proposed opex reductions are greater than other comparable entities. While direct comparison can be difficult, the TER's proposed reductions are vastly greater than what other regulators have proposed over a comparable five year period.

Figure 8: Productivity comparison with other regulators



Given the cumulative impact of our proposed productivity savings, we do not consider that additional opex reductions should be applied. We have broadly accepted Arup's efficiency recommendations and we have applied an additional seven per cent opex reduction ourselves. We do not believe it is reasonable to depart from the TER's method in PSP2 and apply further reductions without explicit evidence of inefficiency.

#### 4.6 Summary of our response to the TER's draft report on regulated operating expenditure

The total impact of the adjustments to our regulated operating expenditure in response to the TER's draft report is shown in the table below.

**Table 19: Response to the TER's draft report on regulated operating expenditure (\$'000s)**

Operating expenditure	FY2018/19	FY2019/20	FY2020/21	PSP3 Total
TasWater proposed opex (draft PSP3 submission)	174,781	178,691	185,260	538,732
TER proposed opex (draft report, revised by Arup)	171,420	173,675	178,199	523,294
TasWater revised opex (response to TER report)	173,754	176,974	182,406	533,133
Difference between our draft PSP3 submission and our revised proposal	-1,027	-1,718	-2,854	-5,599

## 5 Capital expenditure

### 5.1 Facilities, fleet and plant

The TER proposed to reduce our facilities, fleet and plant capex by \$4.9 million in total over PSP3 based on guidance from Arup that our vehicle to staff ratio should be lower to reflect an efficient level. The reduction in our facilities, fleet and plant capex is detailed in the table below.

**Table 20: Proposed facilities, fleet and plant capex for PSP3 (\$'000s)**

Facilities, fleet and plant	FY2018/19	FY2019/20	FY2020/21	PSP3 Total
TasWater proposed capex (draft PSP3 submission)	4,686	4,369	4,480	13,535
TER proposed capex (draft report)	2,999	2,796	2,867	8,662
Difference	-1,687	-1,573	-1,613	-4,873

#### 5.1.1 Our revised facilities, fleet and plant capex in response to the TER's draft report

As we discussed in the opex section above, the vehicle to staff ratio calculated by Arup (1:1.2) was based on TasWater having 760 vehicles – a figure provided to Arup by us. However, this figure was incorrect and actually represented the number of assets in our fleet rather than the number of vehicles in our fleet.

Using the correct data, our vehicle to staff ratio is currently 1:2 which is the PSP3 target recommended by Arup. Consequently we do not consider it necessary to reduce our facilities, fleet and plant capex forecast. Our capex forecast is summarised in the table below.

**Table 21: Response to the TER's draft report on facilities, fleet and plant capex (\$'000s)**

Facilities, fleet and plant	FY2018/19	FY2019/20	FY2020/21	PSP3 Total
TasWater proposed capex (draft PSP3 submission)	4,686	4,369	4,480	13,535
TER proposed capex (draft report)	2,999	2,796	2,867	8,662
TasWater revised capex (response to TER report)	4,686	4,369	4,480	13,535
Difference between our draft PSP3 submission and our revised proposal	0	0	0	0

### 5.2 Gifted assets

Given that gifted assets are removed from the regulated asset base (RAB) in our PSP3 pricing model since customers / developers have already paid for the asset, we did not forecast any gifted assets for PSP3. That is, our capex proposal for PSP3 was net of gifted assets.

In its draft report, the TER considered that it is appropriate to include a forecast for gifted assets in PSP3 based on the most recent actual value of gifted assets in FY2016/17, approximately \$10 million per annum. The TER also reduced our capex allowance<sup>14</sup> in PSP3 by a commensurate amount of \$10 million per annum.

#### 5.2.1 Our revised gifted assets forecast in response to the TER's draft report

We accept the TER's estimate in the draft report and agree with the forecast \$10 million of gifted assets per annum in PSP3. However, as the capital projects for gifted assets were not included in our forecast capex, the forecast capex must be increased by \$10 million. It is essential that the gifted assets be included both in the forecast capex and as a gifted asset deduction so that we do not

<sup>14</sup> The TER commented on our use of the term 'capex allowance' in the draft report. We agree with the TER that it is up to TasWater to decide how much we should spend and which projects we should invest in. Our use of the term allowance refers specifically to the capex amount that is added to our asset base and upon which we are allowed to earn a return during the regulatory period.

receive any compensation for assets that we did not pay for, but also so that we receive compensation for the assets we do pay for (i.e. \$467 million of capex over the PSP3 period).

This will have no change relative to our PSP3 proposal, but increases the RAB relative to the TER's draft decision, which did not include the offsetting increase to forecast capex. Our revised forecast is shown in the table below.

**Table 22: Response to the TER's draft report on gifted assets (\$'000s)**

Gifted assets	FY2018/19	FY2019/20	FY2020/21	PSP3 Total
<b>TasWater draft PSP3 submission</b>				
Gifted assets forecast	0	0	0	0
Proposed capex (inclusive of gifted assets)	143,162	142,367	180,886	466,616
Proposed capex (net of gifted assets)	143,162	142,367	180,886	466,616
<b>TasWater revised proposal</b>				
Gifted assets forecast	10,000	10,000	10,000	30,000
Proposed capex (inclusive of gifted assets)	153,162	152,367	190,886	496,616
Proposed capex (net of gifted assets)	143,162	142,367	180,886	466,616

### 5.3 Summary of our response to the TER's draft report on capital expenditure

The impact of maintaining our original capex on facilities, fleet and plant and adjusted our overall capex forecast to account for the inclusion of gifted assets is shown in the table below.

**Table 23: Response to the TER's draft report on capital expenditure (\$'000s)**

Capital expenditure	FY2018/19	FY2019/20	FY2020/21	PSP3 Total
TasWater proposed capex (draft PSP3 submission)	143,162	142,367	180,886	466,616
TER proposed capex (draft report)	131,675	130,795	169,273	431,743
TasWater revised capex (response to TER report)	153,162	152,367	190,886	496,616
Difference between our draft PSP3 submission and our revised proposal	10,000	10,000	10,000	30,000

## 6 Other matters in the TER's draft report

### 6.1 Working capital allowance

In its draft report, the TER found that:

*The Economic Regulator considers that TasWater has not demonstrated that it has liquidity issues that would warrant the inclusion of a working capital allowance.*

This resulted in a decrease in our allowable revenue of approximately \$4.9 million in total over the PSP3 period.

#### 6.1.1 Our response to the TER's draft report on working capital

We have a need for working capital as, on average, we are required to pay for the services we provide in advance of receiving payment from customers. This is not an unusual business circumstance. As a component of the building blocks, it is not appropriate to disallow required revenue because we do not demonstrate an inability to access short term finance.

As noted by the TER, the fixed components of the bill are charged in advance and the variable components in arrears, depending on actual use. However, in practice, we collect our revenue in the following manner:

- We have four quarterly billing cycles each year (January to March, April to June, July to September, October to December)
- To minimise the cost of meter reading, meters are read at a constant rate over the quarter and then the bill is sent after the meter is read. On average, meters are read in the middle of the quarter
- Customers have 35 days to pay their bill after receiving it
- Therefore, each billing quarter has about 90 days. On average, meters are read and bills are sent on day 45 of the quarter and customers are required to pay their bill on day 80 of the quarter. So, on average our customers pay their bill 35 days after the middle of the quarter – and we receive revenue from our customers after we have provided service to them.

The lag between receiving the service and paying for it is a benefit of the customer. However, this gap needs to be funded by us and it is appropriate to recover this cost through working capital.

The TER has primarily relied on regulatory precedent from the AER, ESC and QCA to not allow a working capital allowance. We have examined the recent decisions of the seven largest Australian economic regulators and found that four out of seven provide a working capital allowance.

The regulators that do not allow a working capital allowance (AER, ESC and ICRC) have an end of year revenue assumption and incorporate cash flow timing adjustments. These regulators assume the cash flow adjustments are sufficient to cover working capital financing requirements, and so a working capital allowance is not required.

However, when a mid-year revenue assumption is used (such as that used by TasWater) all regulators include a working capital allowance. IPART<sup>15</sup> and the QCA<sup>16</sup> have both reviewed the differences between the modelling approaches and considered that a working capital allowance was required.

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<sup>15</sup> IPART, *Comparison of financial models – IPART and Australian Energy Regulator*, 2012 - available at [https://www.ipart.nsw.gov.au/files/sharedassets/website/trimholdingbay/information\\_paper\\_-\\_comparison\\_of\\_financial\\_models\\_-\\_ipart\\_and\\_australian\\_energy\\_regulator\\_-\\_july\\_2012.pdf](https://www.ipart.nsw.gov.au/files/sharedassets/website/trimholdingbay/information_paper_-_comparison_of_financial_models_-_ipart_and_australian_energy_regulator_-_july_2012.pdf)

<sup>16</sup> QCA, *Aurizon Network 2014 Access Undertaking – Volume IV – Maximum Allowable Revenue*, 2016 – available at [http://www.qca.org.au/getattachment/fd4c6285-69b1-4ebb-8c0f-5d990310b0b2/QCA-UT4-Final-Decision-Volume-IV-MAR-\(FINAL.aspx](http://www.qca.org.au/getattachment/fd4c6285-69b1-4ebb-8c0f-5d990310b0b2/QCA-UT4-Final-Decision-Volume-IV-MAR-(FINAL.aspx)

**Table 24: Australian regulatory precedent for working capital**

Regulator	Allows working capital allowance?	Revenue assumption	Comments
AER (national)	No	End of year	<ul style="list-style-type: none"> <li>The AER makes no explicit allowance for working capital</li> <li>The AER uses a post-tax revenue model (PTRM) which assumes revenue is received on the final day of the year but that costs are incurred throughout the year</li> <li>The ACCC (in its electricity regulation role prior to creation of the AER) engaged Allen Consulting Group (ACG) to consider the need to incorporate working capital. ACG found that an additional working capital allowance was not necessary due to the timing assumptions in the PTRM and also that the PTRM's timing assumptions tended to overcompensate service providers</li> <li>The timing assumptions of the PTRM provide sufficient revenue to cover working capital financing costs</li> </ul>
ESC (Victoria)	No	End of year	<ul style="list-style-type: none"> <li>The ESC makes no explicit allowance for working capital</li> <li>The basis for this decision is that, given the assumption regarding return on capital implicit in the building block formula that payments are received at year end, while in practice, utilities receive payments from customers throughout the year, there is already an excess net present value revenue for the return on assets component</li> </ul>
ICRC (Australian Capital Territory)	No	End of year	<ul style="list-style-type: none"> <li>ICON Water used the Post Tax Revenue Model (PTRM) to calculate its costs and revenues. A feature of the PTRM is that revenue is assumed to be received at the end of the year. In practice, revenue is received during the year. Therefore, an additional working capital allowance is not needed as the timing assumptions of the PTRM already compensates ICON Water for the timing differences between the receipt of revenue and the payment of services. ICRC accepted this approach</li> </ul>
IPART (New South Wales)	Yes	Mid-year	<ul style="list-style-type: none"> <li>An allowance for working capital has been provided by IPART, including relevantly: Water NSW (2017-2020); Sydney Water Corporation (2016-20); Hunter Water (2016-20)</li> <li>IPART calculates a mid-year value of return on and of assets in the cost building blocks, because it is assumed revenue is received evenly through the regulatory year rather than in full at year-end. Because of this, IPART recognises a need for an explicit working capital allowance</li> </ul>
ESCOSA (South Australia)	Yes	Mid-year	<ul style="list-style-type: none"> <li>ESCOSA allowed a working capital allowance in its 2016-20 final decision for SA Water</li> <li>The working capital allowance is a product of the regulatory rate of return and the working capital base</li> <li>In its submission to ESCOSA SA Water outlined that it proposed a mid-year revenue assumption (as opposed to the end-of-year revenue assumption used by AER and ESC)</li> </ul>
ERAWA (Western Australia)	Yes	Mid-year	<ul style="list-style-type: none"> <li>A working capital allowance was provided in ERAWA's Final Decision for ATCO Gas Australia in June 2015</li> </ul>
QCA (Queensland)	Yes	Mid-year	<ul style="list-style-type: none"> <li>An allowance for working capital was provided by the QCA, including relevantly: Seqwater (2018-21); Gladstone Area Water Board (2015-20); SunWater (2012-17)</li> <li>In its draft determination, OTTER contended that the QCA's decision to allow SunWater a working capital allowance may be due to cash flow issues associated with 22 customers. This is not correct as SunWater has approximately 5,000 customers across 22 schemes</li> </ul>

Consistent with our draft PSP3 submission, we consider that a working capital allowance should be calculated as a product of the net working capital and the WACC. On 30 June 2017, our net working capital was \$32.6 million as shown in the table below.

**Table 25: Annual working capital components since TasWater's inception (\$'000s)**

Parameter	30 June 2014	30 June 2015	30 June 2016	30 June 2017
Receivables	45,199	46,322	41,937	49,789
Inventories	5,290	5,181	5,587	5,695
Payables	-19,619	-26,324	-22,838	-22,919
<b>Net working capital</b>	<b>30,870</b>	<b>25,179</b>	<b>24,686</b>	<b>32,565</b>

Based on a WACC of 6.42%, we propose an updated working capital allowance of approximately \$2 million per year in PSP3 as shown in the table below.

**Table 26: Response to the TER's draft report on working capital (\$'000s)**

Motor vehicles	FY2018/19	FY2019/20	FY2020/21	PSP3 Total
TasWater proposed working capital (draft PSP3 submission)	1,585	1,621	1,661	4,867
TER proposed working capital (draft report)	0	0	0	0
TasWater revised working capital (response to TER report)	2,185	2,234	2,290	6,710
Difference between our draft PSP3 submission and our revised proposal	600	614	629	1,842

## 6.2 Recognising assets on commissioning

In its draft report, the TER sought feedback on the concept of recognising new capital expenditure in the RAB upon commissioning of the asset. The current practice is to include assets in the RAB while construction is in progress. The TER indicated a change to recognising assets only once they are operational may incentivise us to deliver capital expenditure in a timely manner.

In principle, we support this concept since our desire is to deliver capital – and improve customer outcomes – as quickly as possible provided it is prudent and efficient to do so. However, a change to recognising assets upon commissioning was not included in the PSP3 Guideline issued by the TER. Accordingly, our capital expenditure planning, PSP3 price modelling, and long term financial modelling does not take this change into account since we could not have anticipated it. It would be a substantial exercise for us to revise our planning, modelling and finances prior to the start of PSP3.

In addition, transitional arrangements would need to be put in place for work in progress (some of which is already included in the RAB) and the Water and Sewerage Accounting Ring Fencing Guideline would also need to be updated.

We do not believe all of this could occur in an orderly manner by July 2018. Therefore, we do not believe it is appropriate to make this change for the PSP3 period. Instead, we suggest the TER includes this change in the draft PSP4 Guideline for consideration.

## 6.3 Service replacement

### 6.3.1 Service replacement process

Our proposed service replacement process builds upon the PSP2 process and provides improvements based on experience with service replacement in the communities of Mountain River and Pioneer.



The TER has proposed to require us to retain the current PSP2 process, yet accepted some of the new features of the PSP3 process, such as the introduction of a community threshold, a limited offer period and minor wording changes.

The PSP2 process had a number of limitations, which we have sought to address in the PSP3 process. These included:

- A single customer could hold up the service replacement process for an entire community with no end date
- The timing of the customer review process with the Ombudsman suggested a limited compliance review capability of the Ombudsman. Further, customers who did not accept the service replacement offer did not necessarily have a complaint about the process, rather the offer was not aligned with their expectations
- Limited engagement with the TER and Department of Health and Human Services (DHHS). This creates the risk of us undertaking the process in good faith, yet regulators may have a different view at the end of the process.

To address these issues the PSP3 process includes:

- An 80 per cent threshold for acceptance of an irrigation offer and to proceed to make amendments to serviced land
- A set maximum offer period of 150 days (5 months)
- Review points at the end of each stage of the service replacement process to get in-principle agreement from the TER and relevant regulators (such as DHHS, Tasmanian Fire Service) to proceed to the next stage. For example, to test whether our customer engagement is sufficient and that a range of robust service replacement options were considered.

We acknowledge the concerns of the TER regarding Ombudsman review, regulator review and criteria for their assessment. Therefore we propose to use the service replacement process outlined in our draft PSP3 submission, but updated to provide the following additional detail:

- A clear statement that Ombudsman complaint review can be sought at any stage of the service replacement process
- The regulators that will be engaged for their in-principle agreement at the end of each stage and the criteria and evidence for their consideration
- Examples of service replacement options that may be presented to communities: for example rainwater tanks, which reflect local conditions and customer needs.

The revised service replacement process is shown in Appendix 1.

### **6.3.2 Cash for service replacement**

The TER intends to prevent TasWater from offering the option of cash to customers to undertake the installation of assets for service replacement. The TER lists two reasons for this determination:

1. The Director of Public Health has raised concerns since it is not clear when the Director of Public Health can give its approval and
2. There is a risk that a customer could use the money for purposes other than the installation of the appropriate assets.

On the first point, the review points at each stage of the process will demonstrate, transparently, the options that have been considered and how these meet community, health, and other needs. The Director of Public Health and other relevant regulators will need to give their in-principle agreement before we can proceed to the next stage in the process.

On the second point, we firmly believe that it is local communities, supported by information from regulators and ourselves, which are best placed to determine the service replacement option that meets their needs. By excluding cash as an option for service replacement, the TER prohibits customers from selecting a service replacement option they may prefer (and which may be the least cost solution for TasWater). It also limits the ability of a customer to choose the type, quality and reliability of replacement service they desire.

For example, a community may have a high number of holiday owners who visit for weekends, a few times a year. Imposing a rainwater tank may not meet their needs and may even have adverse health impacts as infrequent visits may not allow for sufficient maintenance to the roof, guttering and rainwater tank to ensure safe drinking water. These customers may prefer to allocate funds to purchasing drinking water from the supermarket for the few times they visit their property each year, while other residents may prefer to install a rainwater tank.

The community holds the power to support or reject a service replacement option and without their agreement we cannot proceed. In addition, regulators must provide their in-principle agreement before we proceed to the next stage in the process.

With these safeguards in place we must provide considered, robust service replacement options developed through customer consultation. We think it very unlikely that the community or regulators would accept us considering a single option for service replacement. We firmly believe that all options should be on the table until they can be assessed by the community, regulators and ourselves.

#### **6.4 Trade waste application fee**

In its draft report, the TER noted that we did not justify the step change increase for the trade waste application fee between the final year of PSP2 (\$141.60) and the first year of PSP3 (\$193). As a result, the TER proposed that the trade waste application fee be set in FY2018/19 based on a 4.16 per cent increase from the FY2017/18 fee.

The reason we proposed a higher fee in FY2018/19 is because we recently reviewed the actual time taken to process trade waste applications. Based on this review, each trade waste application takes approximately 2.1 hours to process and is undertaken by staff with a forecast average labour cost of \$91.84 per hour in FY2018/19. On this basis (2.1 hours x \$91.84 per hour), we set the trade waste application fee at \$193 in FY2018/19. We believe the TER should set the fee accordingly.

#### **6.5 Labour force plan and asset rationalisation plan**

The TER has indicated a requirement for us to develop a labour force plan and long term asset rationalisation plan in PSP3. While we believe the TER should use the PSP process to focus on the outcomes we deliver rather than dictate the inputs of how we run our business, we are not opposed to the development of these plans in principle.

Our understanding of the scope of these plans is outlined below at a high level. Provided this scope aligns with the TER's intent, we believe we can complete these plans within our existing opex envelope.

##### **6.5.1 Scope of the labour force plan**

We understand the scope of the labour force plan is to:

- Be commensurate with the level of data available to TasWater to develop the plan (i.e., it will necessarily require assumptions and contain greater uncertainty in its initial version, and evolve over time to have more detail and accuracy)
- Include a five-year outlook and be reviewed and updated on a rolling three-yearly cycle

- Include an estimate of the number and skill sets of full time equivalents (FTEs) within TasWater
- Include sections on skill development and productivity improvement and
- Provide justification for TasWater's salaries expenditure from PSP4 onwards.

Arup's recommendation, which the TER has accepted, also states that the labour force plan should itemise the role and utilisation of insourced and outsourced FTE resources. We agree that it is appropriate to continuously review labour sourcing decisions to ensure customers receive value for money. However, we do not agree that this should be made available in the proposed labour force plan given the sensitive nature of this topic. We believe this should be excluded from the scope.

### **6.5.2 Scope of the asset rationalisation plan**

We understand the scope of the asset rationalisation plan is to:

- Be commensurate with the level of data available to TasWater to develop the plan (i.e., it will necessarily require assumptions and contain greater uncertainty in its initial version, and evolve over time to have more detail and accuracy)
- Demonstrate how regional strategies and planning are taken into account within TasWater's overarching asset management framework
- Identify systems, treatment plants or other major assets that may be impacted by future rationalisation opportunities
- Identify timing and indicative cost estimates for more detailed studies or projects that are planned or underway to confirm the viability (or otherwise) of rationalisation opportunities and
- Be used to provide justification that capex proposed in PSP4 and beyond is not creating a risk of stranded and/or operationally inefficient assets.

## **6.6 Correction of items in our draft PSP3 submission**

We also propose to make a number of minor corrections to the content in our draft PSP3 submission in our final PSP3 document to clarify our intent and terminology. The corrections include items that were included in our final PSP2 document that were inadvertently omitted from the text in our draft PSP3 submission. For example, these corrections include:

- Language specifying that a customer's ET assessment will result in a minimum of one ET being applied (section 6.6.1 of PSP2)
- Clarifying terminology for trade waste non-compliance charges to state they are annual rather than one-off fees and
- Specifying which miscellaneous services fees are inclusive of GST.

We do not believe the corrections we have identified are materially important to include in this response, but we can provide them to the TER upon request.

## 7 Conclusion

Our vision is to be a trusted and respected provider of essential services that is making a positive difference to Tasmania. This vision reflects the strong desire of the Board and employees of TasWater to focus on what really matters for our owners, customers and the general community who are dependent on us for essential services.

To achieve this vision, our draft PSP3 submission to the TER outlined a set of activities and investments that would provide the services and outcomes expected by our customers and stakeholders.

Our response to the TER's draft report on our submission focuses on the small number of issues where we have a differing viewpoint – mainly due to incorrect or incomplete data or calculation methods. Therefore, our response seeks to provide comprehensive information to the TER to ensure the final PSP3 represents a set of proposals that deliver the best long term outcomes for customers.

Our response above provides further information to the TER with respect to:

- Weighted average cost of capital (WACC)
- Regulatory depreciation
- Operating expenditure
- Capital expenditure and
- Other matters in the TER's draft report.

The impact of our response and revised proposal on the maximum allowed regulated revenue (MARR) is shown in the table below.

**Table 27: Response to the TER's draft report on MARR (\$'000s)**

Maximum allowed regulated revenue	FY2018/19	FY2019/20	FY2020/21	PSP3 Total
TasWater proposed MARR (draft PSP3 submission)	395,085	410,378	419,722	1,225,185
TER proposed MARR (draft report, revised by Arup)	341,436	352,669	367,580	1,061,685
TasWater revised MARR (response to TER report)	374,762	390,507	401,940	1,167,209
Difference between our draft PSP3 submission and our revised proposal	-20,323	-19,871	-17,782	-57,977

We will provide our revised pricing model incorporating these changes to the TER separately.

## Appendix 1: Revised service replacement process

## Service Replacement Process

### Aim

The aim of this document is to detail the process we will follow where service replacement may be required for existing water services.

### Overview

A small number of our water services in the past may not have complied with the Tasmanian Drinking Water Quality Guidelines (TDWQG) and by extension the Australian Drinking Water Guidelines (ADWG).

The Economic Regulator, through our water and sewerage operating licence, and the Director of Public Health, through the provisions of the *Public Health Act 1997*, require all drinking water systems to comply with the health requirements of the ADWG. In practice, this means that most of our drinking water systems require full treatment. Historically this provided us with only two options: conform to the requirements of ADWG or instigate service replacement.

Service replacement means that we would no longer provide a reticulated drinking water service to a locality. This solution is only considered when all other reasonable solutions have been considered.

We may provide, at our discretion, an irrigation supply in response to community demand and support. All costs for this unregulated supply will be borne by the local community through individual agreements.

### Service Replacement Process

Our framework for the assessment of options for how water services are provided to communities within small towns includes our *Water Quality Policy*, and the supporting *Small Towns Water Supply Guideline*. These are available on our website at [www.taswater.com.au](http://www.taswater.com.au).

The Policy and Guideline seek to balance the compliance obligation to provide a safe drinking water supply and the economic justification, in line with our legislative obligations, of major investment in towns with very small populations. They also incorporate non-economic considerations that may warrant the installation of treatment infrastructure in meeting compliance obligations. These include consideration of a range of criteria relating to community health, regional planning, growth and demographic issues, town sustainability and organisational reputation. Public safety is the principal objective in determining our preferred approach for a locality.

We will follow the process outlined in this paper where service replacement is a possible solution to address water quality issue.

### Review points

The process provides 'review points' at the end of each major section of the process to allow us to engage with the TER and other regulators as appropriate, such as the Department of Health and Human Services (DHHS), EPA Tasmania and the Tasmania Fire Service (TFS). Regulators at each review point will need to give their in-principle agreement before we can proceed to the next stage in the process.

Relevant regulators will be provided with information and asked to consider certain matters outlined below and detailed in the series of flowcharts that follow. The list below is not prescriptive and does not seek to limit regulators' ability to request further information at the review points or at any time during the process.

#### *Stage 1.1 – Initial assessment*

- Review point regulators: TER and DHHS

- Regulators asked to consider our assessment of the town against the *Small Towns Water Supply Guideline* key assessment criteria and the need to commence the service replacement process

#### *Stage 1.2 – Engage with community and regulators*

- Review point regulators: TER, DHHS and TFS
- TER asked to consider the adequacy of community engagement
- TER and DHHS asked to consider:
  - Whether the options presented to the community adequately addressed the risks, costs and benefits of each option
  - Whether the proposed implementation approach (reimbursement or upfront payment) justified
- All regulators asked to consider whether options adequately address their particular regulatory concern(s). For example, TFS may consider the impacts of the proposed service replacement on firefighting capability within the locality.

#### *Stage 1.3 – Customer offers and review*

- Review point regulators: TER, DHHS and TFS
- TER asked to consider whether the Service Replacement Offer(s) matched the outcomes of the community engagement and the needs of customers, and the robustness of the process of gaining customer agreement
- TER and DHHS asked to consider:
  - Whether the Service Replacement Offer(s) presented to customers adequately explained included the costs and ongoing requirements and the proposed implementation approach
- All regulators asked to consider whether the Service Replacement Offer(s) adequately addressed their particular regulatory concern(s).

#### *Stage 1.4 - Amendment to Serviced Land*

- Review point regulators: TER, DHHS and TFS.
- Stage includes TER consultation with other regulators and, if required, public consultation in relation to our Service replacement process report.
- TER final review

#### *Stage 1.5 – Installation of alternative supply*

- Review point regulator: TER
- Advice to DHHS and TFS of completion of the service replacement process

### **Customer complaints**

Customers who have a complaint with any part the process may lodge a formal complaint with us through a range of avenues, as detailed on our website [www.taswater.com.au](http://www.taswater.com.au). If the customer remains dissatisfied with our response, we will advise the customer of their right to lodge a complaint with the Tasmanian Ombudsman. The Tasmanian Ombudsman can only investigate a complaint when attempts have been made to resolve the issue with us.

Further details of the procedure and how to make a complaint are available on the Tasmanian Ombudsman's website at [www.ombudsman.tas.gov.au](http://www.ombudsman.tas.gov.au).



## Engagement

Engagement informs and drives the service replacement process. We will engage with our customers in the relevant localities, the local council and regulators. Other stakeholders will also be engaged as required.

This engagement is an important part of the decision-making process for determining the form of the preferred solution and to make sure we meet our legal obligations.

As part of stage 1.2 – Engagement with community and regulators (refer to flowchart below) we will provide the community with a number of detailed options and the ongoing costs and obligations. The options presented will weigh up matters such as:

- Quality and quantity of water supply (eg rainfall, surface and bore)
- Upfront infrastructure costs
- Ongoing costs and maintenance obligations for customers
- Existing investment by customers in their own water supplies eg rainwater tanks
- Community composition eg the proportion of permanent residents to occasional and temporary visitors. Lower permanent resident levels may influence the option(s) proposed by TasWater.

Examples of options that we have considered in the past include: the provision of water tanks and/or water filters to individual properties and community water tanks. Community requirements will determine whether the preferred option will be implemented through reimbursement of costs (subject to an appropriate cap) or upfront flat fee payment.

In some cases it is not possible to get all customers to indicate their preferences. We will make all reasonable endeavours to engage with the community, including methods such as telephone contact, direct mail outs, advertisements in local shops and/or newspapers and community meetings.

The second part of the community engagement is to get formal agreement from individual customers. For each customer we will provide details of the service replacement offer and an agreement to accept the offer.

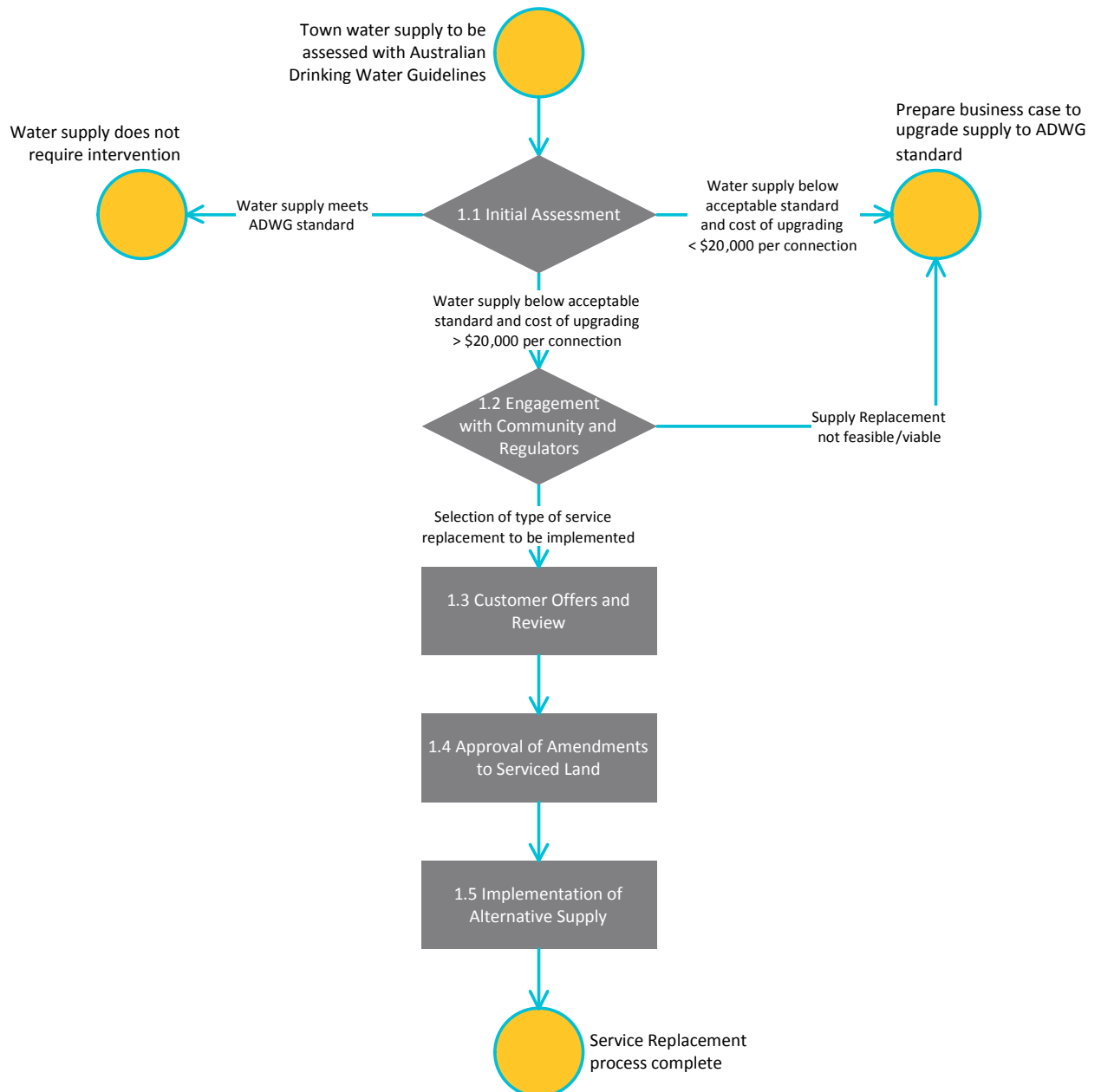
Customers will be provided with up to 150 days (5 months) to accept or reject the offer (the 'offer period').

Our *Water and Sewerage Network and Charges Policies* document, available on our website, details our policies regarding service charges (Section 5), connections (Section 2) and serviced land (Section 3).

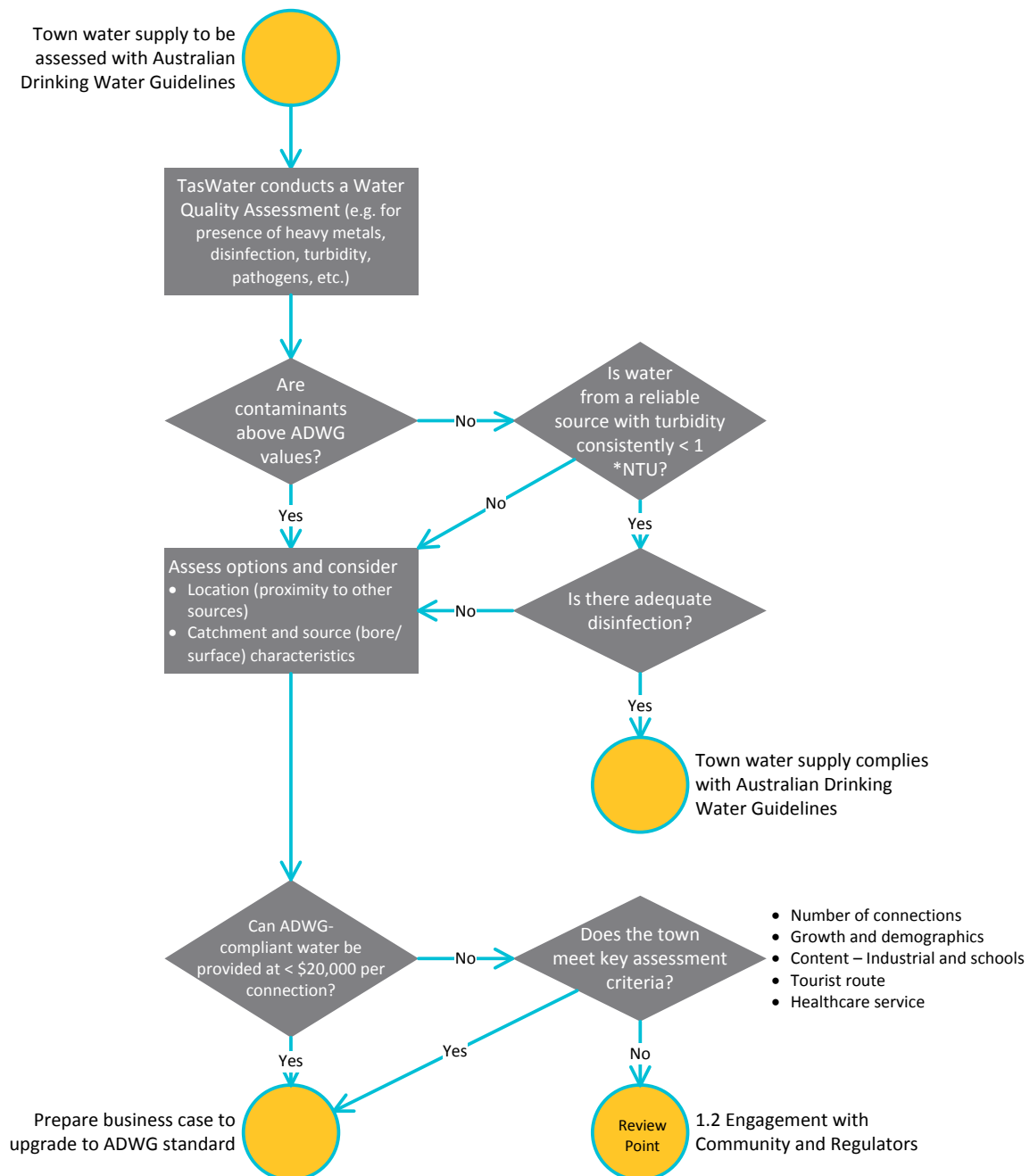
We will proceed to seek an amendment to serviced land at the end of the offer period if 80 per cent or more of customers have accepted the offer. Should this threshold not be met at the end of the offer period we will consult with the relevant regulators to determine an acceptable resolution.

The service replacement process is detailed in the series of flowcharts that follow.

**Figure 1: Service replacement overview**

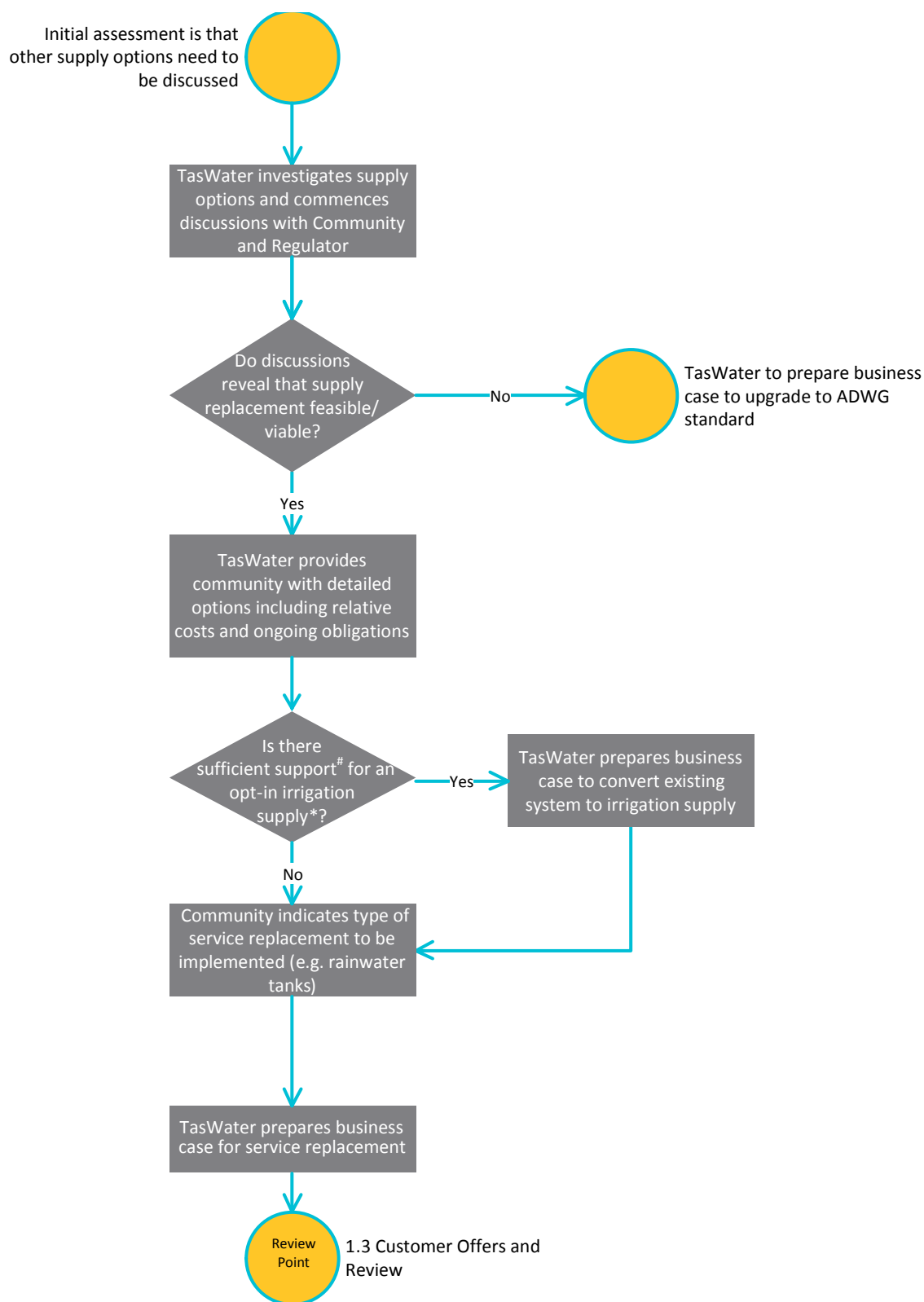


**Figure 2: 1.1 - Initial assessment**



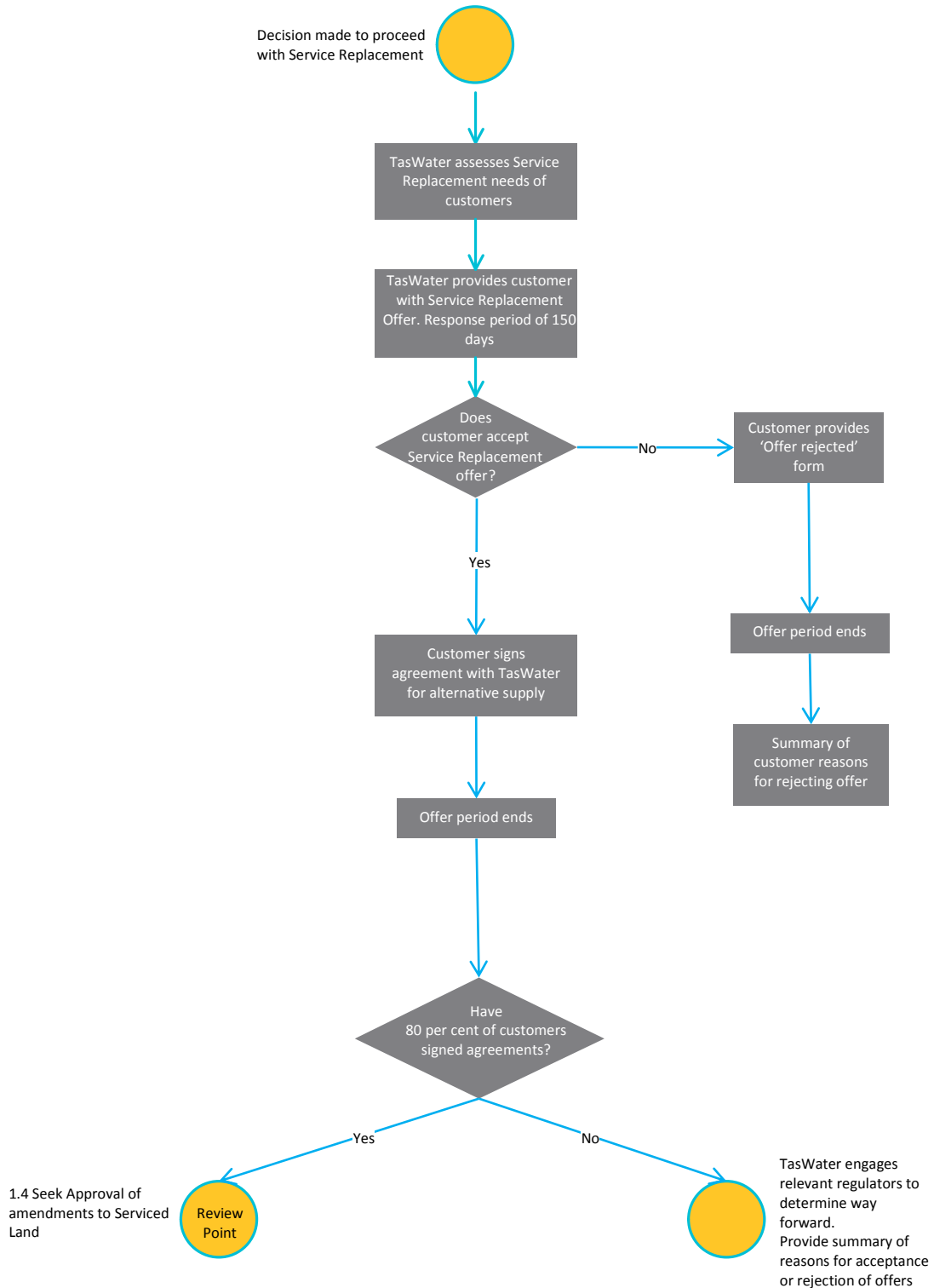
\* NTU is a Nephelometric Turbidity Unit, a measure of the water's clarity affected by fine suspended particles.

Figure 3: 1.2 – Engagement with community and regulators

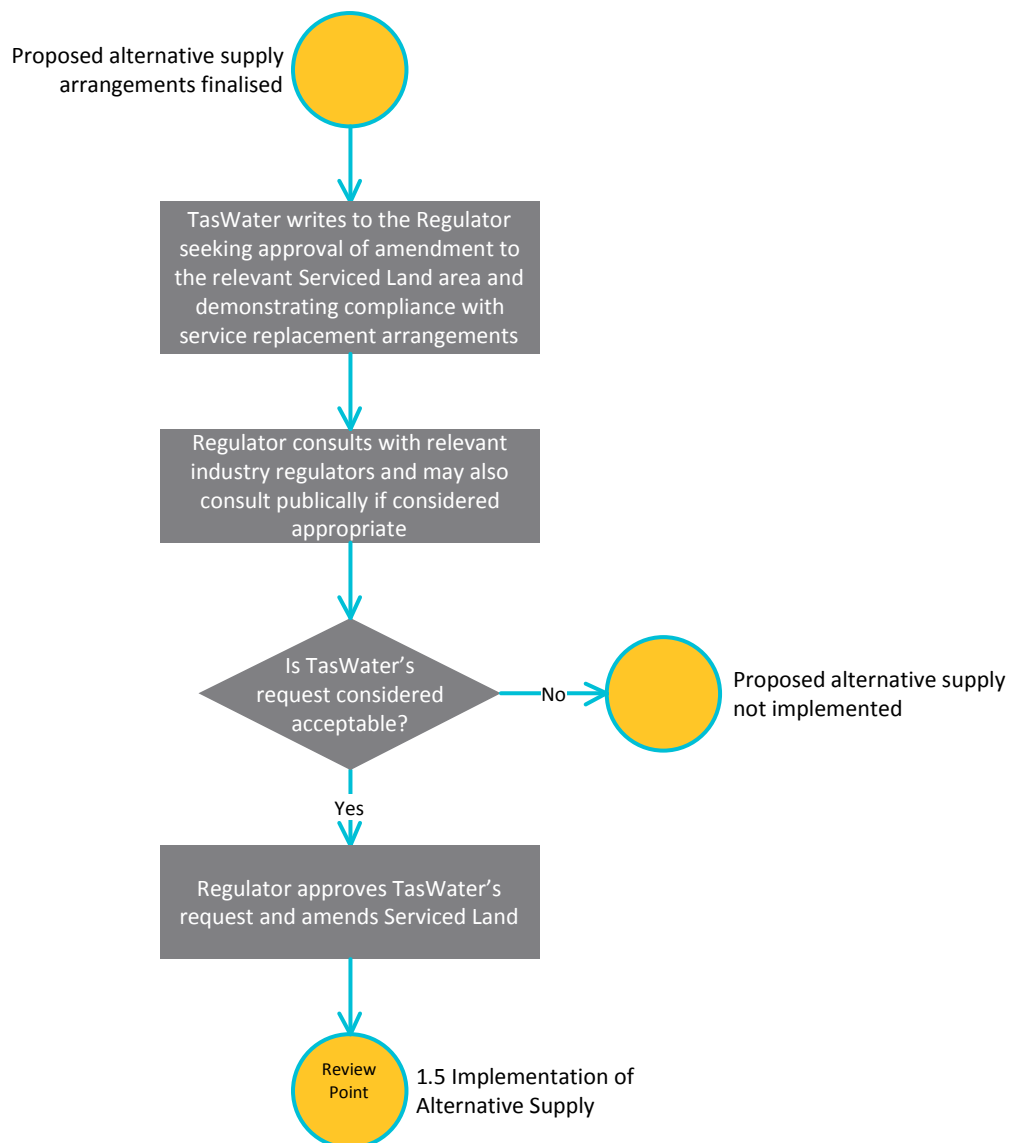


# Sufficient support is 80 per cent of customers in serviced area  
\*To be maintained at the user's expense.

**Figure 4: 1.3 – Customer offers and review**



**Figure 5: 1.4 – Amendment to Serviced Land**



**Figure 6: 1.5 – Installation of alternative supply**

