

EXECUTIVE SUMMARY

This Draft Report presents the outcomes proposed by the Economic Regulator as part of the second independent price determination investigation for the Tasmanian water and sewerage industry.

The water and sewerage industry is critical to public health, the protection of the environment and economic development potential across Tasmania.

Due to the extent of the challenges currently facing the industry, not all concerns of customers, stakeholders and regulators will be able to be addressed during the second regulatory period.

However, it is considered that the proposals contained in this Draft Report strike an appropriate balance between a number of competing objectives and represent an important further step towards improving the sustainability and performance of the Tasmanian water and sewerage industry and in delivering better outcomes for customers and stakeholders.

Public comment is now sought on the proposals contained in this Draft Report.

Background

The Tasmanian water and sewerage industry has undergone significant structural and regulatory reform over recent years.

From 1 July 2009, three regional corporations - Ben Lomond Water, Cradle Mountain Water and Southern Water - were established and provided water and sewerage services previously provided by 29 local councils. The three regional water corporations were subsequently amalgamated into a new single entity, the Tasmanian Water and Sewerage Corporation Pty Ltd (TasWater), from 1 July 2013.

As part of the reforms, an economic regulatory framework was introduced for the industry, in addition to existing industry based regulatory arrangements in relation to public health, environmental protection and dam safety. The economic regulatory framework provides for the regulation of both water and sewerage prices and services.

In mid-2014, the Economic Regulator started an investigation to make the second independent price determination for the Tasmanian water and sewerage industry which would apply to TasWater from 1 July 2015.

Chapter 1 contains more information on the context for the second price determination investigation and the regulatory framework applying to the Tasmanian water and sewerage industry.

Challenges facing the Tasmanian water and sewerage industry

The reforms of the Tasmanian water and sewerage industry were undertaken to address a number of issues identified by a State Government review.

These issues included:

- entities which weren't financially sustainable into the future due to the extent that revenue was under-recovered relative to costs;
- inadequate or unknown performance in relation to drinking water quality, with a number of permanent or temporary boil water alerts in place across the State;
- widespread non-compliance of sewage treatment plants with their respective environmental permits;
- inadequate, or non-existent, asset management practices, particularly in relation to dam safety;
- inadequate, or unknown, customer service standards; and
- a myriad of different pricing structures across council areas, with prices often applied on an unfair basis without reflecting actual costs.

These issues have developed over years, if not decades. Fully addressing these issues will require significant time and capital investment.

Further details on the issues facing the industry and the previous regulated entities performance during their last year of operation prior to amalgamation are outlined in the 2012-13 Tasmanian Water and Sewerage State of the Industry Report, released by the Economic Regulator on 27 March 2014.

Approach to second price determination investigation

As was the case for the first price determination investigation, the regulatory approach adopted for the second price determination investigation reflects that TasWater expects to earn revenue that is substantially below the level required to achieve full cost recovery.

In undertaking its investigation, the Economic Regulator has followed the standard regulatory approach of assessing and determining revenues, prices and service standards.

More particularly, the Economic Regulator's investigation approach has necessitated achieving a balance between:

- continuing to transition customers to a rational price structure whereby ultimately customers will pay the same price for the same service;
- ensuring that TasWater generates revenue that is at least equal to the lower revenue limit necessary to achieve sustainability; and

- managing the impact of price changes on customers.

Chapter 2 outlines in more detail the approach to the second price determination investigation together with a list of the key activities and timelines for the next steps in the process.

Regulatory compliance improvement

One of the key drivers of the Tasmanian Government’s reform of the water and sewerage industry was the need to improve levels of compliance with regulatory obligations.

Broader regulatory compliance improvement and enforcement across the water and sewerage sector remains the responsibility of the Tasmanian industry regulators, being the Environment Protection Authority (EPA), Director of Public Health and the Secretary of the Department of Primary Industries, Parks, Water and Environment (DPIPWE), who is the Delegate for Dam Safety Regulation.

The Economic Regulator notes that TasWater has liaised with the other Tasmanian industry regulators in preparing its proposed price and service plan.

The Economic Regulator will consult with the other Tasmanian industry regulators after public consultation and prior to the release of the Final Report and final Price Determination to ensure TasWater’s final Price and Service Plan reflects the compliance improvement outcomes agreed to between TasWater and industry regulators.

Chapter 3 provides more detail on regulatory compliance improvement.

Revenue allowance

The primary focus of the second price determination investigation is the regulation of prices rather than revenue. However, it is important to establish revenue limits as part of the second price determination investigation as it enables a comparison against expected revenue in each year to:

- assess whether TasWater is expected to achieve a financially sustainable level of revenue during the second regulatory period; and
- provide a basis of comparison to identify the extent of further revenue increases required to reach the statutory legislative revenue limit.

To assist with its investigation and to ensure TasWater’s revenue allowance is based on efficient costs and asset values, the Economic Regulator engaged an external consultant, Jacobs Group (Australia), to conduct an independent review of TasWater’s operating and capital expenditure (including asset values). A copy of Jacobs’ report is available on the Economic Regulator’s website.

The Economic Regulator has assessed the revenue that TasWater expects to receive in each year of the second regulatory period and compared this against the following revenue limits:

- the upper revenue limit (full cost recovery);
- the lower revenue limit (sustainability threshold); and
- the statutory limit (the maximum revenue permitted under the Industry Act).

The Economic Regulator has proposed alternative values for a number of the revenue limit components resulting in lower revenue limits to those proposed by TasWater in its price and service plan.

Chapter 4 provides more detail on the calculation and analysis of revenue limits.

Structure of proposed water and sewerage prices

Prior to the industry reform process, the prices charged by local governments for water and sewerage services varied markedly between municipalities in terms of both the basis for setting prices and the levels of prices.

Many of these issues with the structure of water and sewerage pricing were addressed as part of the first water and sewerage price determination investigation. TasWater's proposed pricing structure is basically consistent with the previously approved arrangements.

The Economic Regulator proposes approving the TasWater's proposed basis and structure of tariffs where:

- fixed water charges will be determined on the size of the water connection;
- variable water charges will be determined on water usage; and
- sewerage charges will be determined based on the assessed demand a property is expected to place on the water and sewerage infrastructure.

Sections 5.3 and 5.4 in Chapter 5 provide further information on the structure and basis of TasWater's proposed water and sewerage prices.

Price changes

In its proposed price and service plan, TasWater proposed an approach that continued the price transition commenced by the previous regulated entities ie TasWater proposed transitioning customers above and below target to the relevant target by set proportions and by dollar amounts or percentages respectively. The Economic Regulator is generally supportive of this approach as it transitions customers above target to the relevant target and manages the impact upon customers transitioning up to target.

However, in assessing TasWater's price transition proposal the Economic Regulator considered that TasWater's forecast revenue exceeded the lower revenue limit by a significant margin and was approaching the statutory revenue limit during the second regulatory period. The Economic Regulator also compared actual revenue with forecast revenue for both TasWater and for the previous regulated entities and

concluded that revenue had been significantly under-estimated in each of the 2012-13 and 2013-14 financial years and was again expected to exceed forecast by a significant amount in 2014-15.

The Economic Regulator therefore formed the view that TasWater will have sufficient funds available to it to speed up the price transition without threatening its financial sustainability and without causing price shocks for customers transitioning up to the target tariffs during the second regulatory period.

In summary, the Economic Regulator proposes that TasWater adopt the following price transition arrangements for the second regulatory period:

- Customers above their respective target fixed tariffs as at 30 June 2015 will immediately move to their respective target fixed tariffs as from 1 July 2015.
- Most residential customers below their respective target fixed tariffs as at 30 June 2015 will see a maximum annual increase to their combined fixed service charges (water and sewerage) of no more than \$100 or 10 per cent, whichever is the greater, until both fixed water and sewerage target tariffs are reached.
- Non-residential customers below their respective target fixed tariffs as at 30 June 2015 will see the combined \$100 side constraint increased in proportion to their water connection size and the assessed number of ETs.
- Fixed water target tariffs to be held constant at TasWater's proposed 2017-18 level for each year of the second regulatory period.
- Customers on target fixed sewerage tariffs will face price increases of six per cent per annum which is a continuation of the approach that applied through the first regulatory period.
- Customers below the target variable rate will see equal annual increases across the three years of the period so that they arrive at the target rate by 1 July 2017.
- The target variable rate will increase by 2.5 per cent per annum to reflect inflation.
- Trade waste customers will transition to their respective target tariffs by going up or down by one third of the gap to the 2018 target tariffs in each year of the regulatory period depending upon whether they are above or below target tariff.

Further information on price transition arrangements can be found in section 5.6.

Policies and customer contract

TasWater was required to provide a draft customer contract and draft policies in relation to its proposed pricing for certain water and sewerage services together with

policies with respect to its interactions with customers. The policies dealt with issues such as:

- imposing developer charges;
- extending water and sewerage infrastructure;
- introducing new services;
- connecting customers to water and sewerage infrastructure;
- metering arrangements;
- charges in relation to unconnected properties; and
- the management of complaints, enquiries, disputes and customer hardship.

A number of issues were identified with the content of the policies proposed by TasWater. As a result, the Economic Regulator proposes requiring TasWater to redraft the policies to ensure that they are legally effective, comply with the relevant regulatory and legislative provisions, easily understood to the reader and are consistent in their drafting structure and use of terminology.

Chapter 6 provides a detailed discussion about TasWater's draft policies and customer contract.

Customer service

In addition to pricing reform and compliance improvement, one of the key drivers of the Tasmanian Government's reform of the water and sewerage industry was the need to improve levels of customer service.

TasWater's proposed price and service plan did not provide details of different service standards for different parts of the state (ie differential service standards). Instead TasWater proposed a single set of service standards that is intended to apply statewide.

The Economic Regulator noted that a number of the service standards proposed by TasWater appear to be ambitious in light of past performance. However, as this is to the benefit of customers, the Economic Regulator proposes accepting TasWater's proposed service standards, subject to any feedback received during consultation on this Draft Report.

Further information on customer service issues can be found in Chapter 7.

Summary of proposals

A summary of the Economic Regulator's proposals is included in the following section.