

EXECUTIVE SUMMARY

This Report presents the outcomes of the Economic Regulator's 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 other industry regulators will be able to be addressed during the second regulatory period.

However, the Regulator considers that the decisions contained in this Report strike an appropriate balance between a number of competing objectives and represent an important step towards improving TasWater's sustainability and performance in delivering better outcomes for customers and stakeholders.

Background

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

As part of the reforms, an economic regulatory framework was added to the 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 service standards.

On 1 July 2009, three regional corporations - Ben Lomond Water, Cradle Mountain Water and Southern Water - were established to provide water and sewerage services in Tasmania¹. In July 2013, the three regional water corporations were amalgamated into a new single entity, the Tasmanian Water and Sewerage Corporation Pty Ltd (TasWater).

In mid-2014, the Economic Regulator started an investigation in order 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.

¹ Prior to 1 July 2009, water and sewerage services were provided by the 29 local councils in Tasmania.

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 were not 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;
- under investment in maintaining infrastructure up to modern standards;
- widespread non-compliance of wastewater 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, based on prices often applied on an unfair basis without reflecting actual costs.

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

Further details on the issues facing the industry and TasWater's performance during its first year of operation are provided in the 2013-14 *Tasmanian Water and Sewerage State of the Industry Report*, released by the Economic Regulator on 1 April 2015.

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 found 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.

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 industry 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 has also consulted with the other Tasmanian industry regulators after public consultation on its Draft Report and draft Price Determination and prior to the release of the Final Report and 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 has been the regulation of prices rather than the regulation of revenue. However, it is important to establish revenue limits for the second regulatory period 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 (ie greater than the lower revenue limit) during the second regulatory period; and
- provide a basis of comparison to identify the extent of further revenue increases required to reach the statutory 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 statutory revenue limit (the maximum revenue permitted under the Industry Act); and
- the lower revenue limit (sustainability threshold).

The Economic Regulator has decided on alternative values for a number of the revenue limit components resulting in revenue limits that are lower than those submitted by TasWater in its proposed 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 has approved TasWater's proposed basis and structure of tariffs, for the second regulatory period, where:

- fixed water charges are determined on the size of the water connection;
- variable water charges are determined on water usage; and
- sewerage charges are 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 approved water and sewerage prices.

Price changes

TasWater's proposed Price and Service Plan, TasWater outlined an approach that continued the price transition commenced by the previous regulated entities; whereby customers above and below the target tariff are transitioned 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 of price increases upon customers transitioning up to target tariffs.

However, in assessing TasWater’s price transition proposal the Economic Regulator considered that TasWater’s forecast revenue for the second regulatory period exceeded the lower revenue limit by a significant margin and was approaching the statutory revenue limit during the period.

The Economic Regulator has therefore formed the view that TasWater will have the financial capacity to speed up the price transition without causing price shocks for customers transitioning up to the target tariffs during the second regulatory period.

In summary, the Economic Regulator has required TasWater to adopt the following price transition arrangements for the second regulatory period:

- Customers above their respective fixed target 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 fixed target 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 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 price constraint increased in proportion to their water connection size and the assessed number of Equivalent Tenements (ETs).
- TasWater’s proposed 2017-18 fixed water target tariffs are to apply for each year of the second regulatory period.
- Customers on fixed sewerage target tariffs will face price increases of six per cent per annum. This is a continuation of the approach that applied during the first regulatory period.
- Customers below the variable water target rate will see equal annual increases across the three years of the second regulatory period so that they reach the target rate by 1 July 2017.
- The variable water target 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 the 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 governing 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;
- sub-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 has required 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 price reform and 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 customer service levels.

TasWater's proposed Price and Service Plan did not provide the required details of different service standards for different parts of the state (ie differential service standards). Instead TasWater proposed a single set of average service standards to apply statewide.

The Economic Regulator raised concerns about differential service standards not having been addressed and subsequently proposed, in its Draft Report, to approve the current minimum service standards as outlined Schedule 1 of the Customer Service Code as actual minimum standards for the second regulatory period.

In response, TasWater noted it did not necessarily agree with the Economic Regulator's intentions in this regard, however would be open to exploring the possibility of setting actual minimum standards for some of the current indicators. To this end, TasWater provided a secondary proposal in relation to customer service standards for the Economic Regulator's consideration. This proposal included revised 'actual minimum' service standards for 'response time' and 'duration related' indicators as well as those service standards relevant to 'water supply interruptions' and 'sewer breaks and chokes' indicators. TasWater also proposed an alternative

approach whereby some of the standards required the targets to be met a certain percentage of the time.

The Economic Regulator has approved TasWater's revised customer service standards proposal.

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

Summary of decisions

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