



Statement of Reasons

on

**2015 Price Determination Investigation Final Report –
Regulated Water and Sewerage Services in Tasmania**

April 2015

Printed April 2015
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ISBN 978-0-7246-5362-1

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1 INTRODUCTION

In accordance with the provisions of the *Water and Sewerage Industry Act 2008* (the Industry Act) the Economic Regulator, in January 2015, released its Draft Report, and draft Price Determination, setting out its proposals for the second regulatory period (1 July 2015 to 30 June 2018). The proposals will apply to the Tasmanian Water and Sewerage Corporation Pty Ltd (TasWater) from 1 July 2015.

Public comment was sought on the proposals contained in the Draft Report. The closing date for submissions was 27 February 2015.

The focus of this Statement of Reasons is to discuss issues raised by stakeholders that involved proposed changes to the content of the Draft Report. Submissions providing support for the proposals contained in the Economic Regulator's Draft Report have not been discussed in detail in this Statement of Reasons.

The following chapter presents a summary of the amendments to the Draft Report arising from comments made in the submissions.

The remainder of this Statement of Reasons sets out the Economic Regulator's decisions on the content of the Final Report and Price Determination after considering comments raised in submissions.

2 SUMMARY OF AMENDMENTS FROM PUBLIC SUBMISSIONS

The following table summarises the amendments to the Draft Report arising from comments made in the submissions. A reference is included to where these amendments are discussed in this paper.

Reference in this document	Amendments to Draft Report
3.4	Remove section 5.7.1 of the Draft Report.
4.1	Amend Table 4.3 in section 4.4.1 of the Draft Report to reflect the revised Capex allowances.
4.2	Amend Table 4.18 in section 4.4.7 of the Draft Report to reflect the outcomes from adding back the \$3.781 million subtracted from the base 2013-14 Opex figure and the resultant revised annual Opex allowances for each year of the second regulatory period.
4.4	Amend section 4.4.2 of the Draft Report to correct the indexation errors with respect to the calculation of third party contributions.
4.5	Amend section 4.4.4 of the Draft Report to reflect the Economic Regulator's decision to use the same methodology for calculating both the risk free premium and the debt risk premium ie a combination of weighted average methodology and point in time.
4.6	Amend section 4.4.10 of the Draft Report to clarify the basis for the Economic Regulator's decision with respect to the calculation of TasWater's Asset Renewal Annuity for the second regulatory period.
4.6	Further amend section 4.4.10 of the Draft Report to reflect the impact on the calculation of the Asset Renewal Annuity of the reduction in the $WACC_{NEW}$ between the Economic Regulator's Draft Report (4.58 per cent) and the Final Report (4.26 per cent).
4.8	Amend section 4.4.3 of the Draft Report to clarify the basis for the Economic Regulator's decision with respect to the calculation of TasWater's asset useful lives and regulatory depreciation allowances for the second regulatory period.

4.9	Amend section 5.8.2.2 of the Draft Report to remove the references to revenue over-recovery by TasWater and its predecessors during the first regulatory period.
4.9	Amend section 5.8 of the Draft Report to make clear the reasons for the Economic Regulator concluding that TasWater has the capacity to quicken the pace of price transition ie there is a substantial excess of forecast revenue over the Regulator's calculation of the lower revenue limit for the second regulatory period.
5.1	Amend section 6.1 of the Draft Report to clarify the processes relating to changes to the description of serviced land.
5.1	Amend section 6.1 of the Draft Report to also clarify the basis of TasWater's proposed minimum flow and pressure standards and require TasWater to publish TasWater's Supplement to the Water Services Association of Australia's <i>Water Supply Code of Australia</i> together with any other additional relevant information that would assist customers and stakeholders in understanding any service related restrictions that may apply to their property.
5.1	Further amend section 6.1 of the Draft Report to permit serviced land boundaries to exist within titles.
5.3	Amend Chapter 7 of the Draft Report to reflect TasWater's alternate proposal with respect to customer service standards.
5.5	Amend section 6.2.4 of the Draft Report to require TasWater to provide undertakings to develop and make available supporting documentation that will set out a high level description of the process and procedure to be followed by strata title owners in deciding whether or not to install sub-meters and to publish all relevant sub-metering documentation on its website.
5.5	Further amend section 6.2.4 of the Draft Report to require a combination of TasWater's sub-metering policy and TasWater's supporting documentation relating to sub-metering to address the issues listed in section 5.5 of this Statement of Reasons.
6.5	Amend section 5.3.7 of the Draft Report to reflect the adoption of the Economic Regulator's alternate approach to determining caravan park ETs.

6.6	Amend section 5.3.16 of the Draft Report so as the approved motor home dump point charges for the second regulatory period apply only to dump points located outside caravan parks.
6.7	Amend section 6.2.6 of the Draft Report to require TasWater to disclose details of any instances where it has departed from the discharge factors specified in the <i>Liquid Trade Waste Regulation Guidelines</i> together with the justification for the adoption of the revised factors.
6.8	Amend Table 5.8 in section 5.4 of the Draft Report to insert the correct charge for the supply and installation of a 20mm water meter.
6.8	Amend Table 5.14 in section 5.5.3 of the Draft Report to reflect the revised forecasts of the number of miscellaneous transactions.
6.10	Amend section 5.4.2 of the Draft Report to reflect the replacement of the references to Equivalent Population (EP) with references to Equivalent Tenements (ET) and require TasWater's final Price and Service Plan to reflect the revised development assessment criteria.
6.11	Amend section 5.3.17 of the Draft Report to reflect the outcomes of the Economic Regulator's discussions with TasWater on the circumstances where customers may either move directly to, or transition to target tariffs.
6.14	Amend section 6.2.5 of the Draft Report to approve TasWater not imposing any headworks charge for developments within serviced land or developments occurring outside of serviced land but utilising existing capacity.
6.14	Further amend section 6.2.5 of the Draft Report to approve TasWater imposing a headworks charge, using the NPV methodology, on the component of a development that can't be satisfied by existing capacity for developments occurring outside serviced land.
7.3	Amend Table 4.16 in section 4.4.6 of the Draft Report to rectify the transposition of the RAB values for new and existing assets.
7.3	Amend section 6.2.3 of the Draft Report to reflect that, during the second regulatory period, TasWater will be continuing to impose a service charge on customers receiving a limited water service.

7.3 Amend Appendix 1 of the Draft Report to reflect the minor changes made to the draft Price Determination.

7.3 Amend Appendix 2 of the Draft Report to reflect the Economic Regulator's recalculation of the lower revenue limit, the statutory revenue limit and the upper revenue limit for each financial year of the second regulatory period.

3 MATTERS OUTSIDE THE ECONOMIC REGULATOR'S CONTROL

A number of submissions on the Draft Report raised matters that are either outside the Economic Regulator's control or are not within its legislated responsibility to address. These issues are discussed briefly in this section to recognise that they were raised during consultation on the Draft Report.

In most cases there is no action listed as, due to their nature, the Economic Regulator has no control over these matters. However, many of these issues do relate to matters of State Government policy. The Economic Regulator will advise the Treasurer and Minister for Primary Industries and Water that these issues were raised during consultation on the Draft Report.

3.1 Affordability and increases in water and sewerage charges and rates

In her submission, Ms Carington-Smith provided information on the increase in her combined water and sewerage charges and council rates over the past few years and the proportion of her disposable income spent on water and sewerage charges.

Mr Nicholas Grieves also believes that one of TasWater's predecessor's, Southern Water, caused a price shock when it adopted the previous local governments' price structures. Mr Grieves also claimed that, for Glenorchy residents, this meant relatively high water and sewerage charges and was combined with increases in Glenorchy Council rates.

Discussion

Due to the current varied pricing arrangements, many customers are paying significantly different prices for the same service. Therefore, the issue of affordability in the Tasmanian water and sewerage sector is complex.

The issue of affordability involves consideration of a range of socio-economic matters and is the responsibility of the State Government. It is also noted that a concessions program is already in place for the industry and the level of concession is a matter of government policy.

The Economic Regulator is, however, required to take into account the impact of price increases upon customers whilst ensuring that TasWater is financially sustainable and able to fund the significant investment to address widespread issues in relation to drinking water quality and environmental and dam safety

compliance and prices continue to transition to equitable pricing arrangements so as customers pay the same amount for the same service.

Consistent with its obligation, the Economic Regulator has established caps on the maximum amount that prices can be increased each year to manage the impact upon customers. Whether customers actually face price increases, and the extent of those increases, depends on what their current pricing arrangements are.

It is the legislated role of the Economic Regulator to ensure that water and sewerage pricing is rational and equitable and is reflective of efficient costs. It is not the role of the Economic Regulator to make water and sewerage less expensive; rather it is to ensure outcomes that are reflective of efficient operations in a competitive market.

It should be noted that current average water and sewerage prices in Tasmania are amongst the lowest in the country (although it is acknowledged that there is a significant degree of variability within this average).

It is also accepted that Tasmania generally does not have significant issues in relation to sourcing water. This does not mean that water and sewerage prices should, therefore, be lower than the rest of Australia. The majority of the costs of providing water and sewerage services are fixed and are associated with the network and its supporting infrastructure, not in sourcing water. Given this, Tasmania's small and dispersed population and its topography are likely to mean that the costs of water and sewerage services may be higher than in some other states.

The Economic Regulator is not responsible for setting or regulating council rates.

3.2 Guaranteed Service Level scheme (GSL)

Submissions from TasCOSS and Anglicare expressed support for the Economic Regulator's proposal that the Government consider the introduction of a Guaranteed Service Level scheme as a way of ensuring that TasWater customers receive adequate service for the price they pay.

In its submission, TasWater raised the following concerns about the introduction of a GSL scheme:

- TasWater does not have the necessary detailed understanding of the physical infrastructure or customer base to be able to accurately measure customer outages both by volume and number;
- TasWater is not in a position to be able to establish an automated GSL payment system; and
- TasWater believes that water businesses are significantly different from electricity distribution and that to move to a GSL arrangement at this

time in the formative part of TasWater's development would be counter-productive to both TasWater and its customers.

In its submission, TasWater recommended that a cost benefit analysis be undertaken prior to any introduction of such a scheme and noted that it wouldn't want a scheme to be introduced at the wrong time thereby shifting TasWater's focus away from priority areas such as its current compliance challenges and its plans to improve water quality and wastewater compliance.

In conclusion, TasWater considered that the introduction of a GSL scheme would not be appropriate, feasible or achievable in the near future, particularly within the next regulatory period. TasWater did however note that it would engage with the State Government on this matter.

Discussion

There is no current legislative authority to introduce a GSL scheme. Whilst recommended by the Economic Regulator for the Government's consideration this is a matter for the Government to consider and decide upon. The Economic Regulator considers that if the Government decided to legislate for the introduction of a GSL scheme, there would need to be a lengthy development period to implement such an arrangement (based on its previous experience in setting up GSL arrangements for the Tasmanian electricity distribution sector).

3.3 Regulatory Compliance Improvement

Submissions from Nekon Pty Ltd and the Property Council of Australia both expressed concerns around the level of non-compliance of TasWater's operations and claimed that only four per cent of TasWater's wastewater treatment plants comply with their respective environmental compliance obligations. Nekon Pty Ltd also considered that the Economic Regulator is not doing enough to ensure TasWater meets its legislative obligations.

Discussion

The challenges facing TasWater in relation to public health, environmental and dam safety compliance are well known and have been highlighted by the Economic Regulator in successive State of the Industry Reports. TasWater is in ongoing discussions with industry regulators and its proposed capital expenditure program is designed to address these issues over time. However, the Economic Regulator is not responsible for other industry regulators' compliance enforcement activities.

3.4 Dividends

Submissions from Oysters Tasmania, Nekon Pty Ltd, the Property Council of Australia and TasCOSS raised concerns about TasWater continuing to pay

dividends to its council owners despite its significant non-compliance with environmental and public health requirements.

Further both Nekon Pty Ltd and Oysters Tasmania believe that TasWater is not following its dividend policy in that it has not been "...act (ing) consistently with good commercial practice, make adequate provision for expected future capital requirements and maintain operational expenditure capacity before payment of dividends to Council owners". Oysters Tasmania also considered it unacceptable for

"... TasWater to continually dispense dividends to their council shareholders while failing to fix their sewage assets which are impacting on other state industries."

In its submission, the Property Council of Australia considers that, despite TasWater's relatively low level of debt, owner councils are preventing additional borrowings to fund infrastructure investment. The Property Council's submission also states that, based on TasWater's revenue forecasts and its ability to redirect dividends, it believes that TasWater will be able to deliver capital infrastructure projects during the second regulatory period.

Discussion

Dividend payments are not a matter within the Economic Regulator's control. Dividend payments are determined by TasWater's Board in line with the requirements of the *Water and Sewerage Corporations Act 2008*. The Economic Regulator has no role in relation to the administration of this Act. Accordingly it is not appropriate for the Economic Regulator to comment on whether TasWater is operating according to good commercial practice or whether, and to what extent, TasWater should make dividend payments to its owners. Ultimately, it is up to TasWater's Board to decide how funds are to be spent including deciding whether dividends will be paid.

The Economic Regulator is however responsible for determining TasWater's maximum regulated revenue and has decided to use a building block approach to make this determination. Under a building block approach a regulated entity's costs are summed to arrive at the maximum amount of revenue the entity is able to earn from its regulated activities. The resultant maximum revenue figure allows for a return on capital (the WACC) and a return of capital (regulatory depreciation) and also provides annual allowances for Opex and Capex provided that proposed capital expenditure is both efficient (ie the expenditure represented the lowest cost means of achieving the desired outcomes) and prudent (ie it was necessary to incur the expenditure). The Economic Regulator appointed an independent expert to review TasWater's proposed capital program in line with these requirements and considering TasWater's physical capacity to manage this expenditure.

Further analysis undertaken by the Economic Regulator demonstrates that TasWater has the capacity to fund the planned regulatory compliance improvement Capex without compromising its financial viability.

Given that the Economic Regulator has no role to play in respect of dividends and the fact that information on returns to owners was presented in the Economic Regulator's Draft Report and is publicly available in TasWater's Annual Reports, the Economic Regulator will remove the section of the Draft Report relating to dividend payments.

Decision

Amend the Draft Report to remove section 5.7.1 of the Draft Report.

3.5 Compensation

Mr Grieves suggested that customers who have been paying above the target tariff should be compensated for the additional amounts that they have paid.

The reimbursement of customers who have been paying above target tariffs is outside the Economic Regulator's control.

3.6 Headworks waiver

A number of submitters suggested that the Tasmanian Government's current waiver of headworks charges should be continued beyond its scheduled expiry on 31 March 2016. The continuation of the waiver is outside the Economic Regulator's control ie it is a matter for Government policy. However the arrangements for charging headworks are discussed further in section 6.14.

4 REVENUE REQUIREMENTS

4.1 Capital Expenditure (Capex)

TasWater's submission noted that it had identified an error in converting nominal Capex to real Capex for the second regulatory period and requested that the Economic Regulator review the calculation of the annual Capex allowances.

Discussion

The Economic Regulator has reviewed the Capex figures in its Draft Report and agrees with TasWater that an error has been made in converting the Capex values from nominal to real. This error has resulted in the understatement of the Capex allowances by a total of \$373 000 over the second regulatory period.

Decision

Amend Table 4.3 in section 4.4.1 of the Draft Report to reflect the revised Capex allowances.

4.2 Operational Expenditure (Opex)

In its submission TasWater claimed that the Economic Regulator's Opex figures are in real dollars as opposed to TasWater's Opex figures which are in nominal dollars.

TasWater also noted that it has been unable to reconcile the Economic Regulator's proposed Opex figures to the values recommended by Jacobs Group Australia (Jacobs)¹.

TasWater requested that the Economic Regulator review its analysis to ensure:

- a consistent use of either real or nominal values;
- correct indexing of Opex values specified in the final report for the first regulatory period, and
- inclusion of additional Opex in response to proposed Capex.

Nominal/real differences aside, TasWater claims its higher Opex (relative to Jacobs' recommendation) is justified as Jacobs' Opex is based on data used for the first regulatory period which TasWater claims was incomplete and did not include costs not identified at the time ie Jacobs' recommended Opex allowance was based on forecast Opex from the early stages of the former regional corporations' existence

¹ To assist with its investigation the Economic Regulator engaged an independent consultant, Jacobs, to review and report on the previous regional corporations' and TasWater's Opex, Capex and asset values. A copy of Jacobs' final report is available on the Economic Regulator's website.

and was therefore reliant on incomplete data and were developed at a time when there were many unknowns about the operation of the business.

Discussion

The Economic Regulator has reviewed and confirmed the accuracy of the Opex figures proposed in the Economic Regulator's Draft Report (including conversion of nominal values to 2014-15 dollars).

As to the calculation of the annual Opex allowances, TasWater is of the view that Jacobs was only referring to regulated Opex so that the \$3.781 million reduction in the 2013-14 base figure to remove the unregulated component of Opex is not required to be made. The Economic Regulator has further reviewed this issue and agrees with TasWater's position.

The Economic Regulator notes that Jacobs recommended, and the Economic Regulator has accepted, the inclusion of annual Opex allowances in recognition of the expected additional Opex associated with TasWater's Capex program. The Economic Regulator also notes that TasWater has not provided any evidence to support its claim of previously unidentified Opex costs.

Decision

Amend Table 4.18 in section 4.4.7 of the Draft Report to reflect the outcomes from adding back the \$3.781 million subtracted from the base 2013-14 Opex figure and the resultant revised annual Opex allowances for each year of the second regulatory period.

4.3 Opening Regulated Asset Base (RAB)

In its submission, TasWater notes that the Economic Regulator has calculated the opening RAB to be \$36.9 million lower than that proposed by TasWater and contends that the Economic Regulator's approach to recalculating the RAB was flawed.

Discussion

In calculating the opening RAB the Economic Regulator adjusted the final RAB value as at 30 June 2016 to account for the \$64 million of forecast Capex identified by Jacobs as not having been delivered during the first regulatory period.

In its submission, TasWater stated that its calculation for the Opening RAB included the actual opening RAB for the first regulatory period, the Capex for 2012-13 and 2013-14 and the budgeted Capex for 2014-15. Further to this, TasWater stated that it had also accounted for:

- variations in, and substitution of projects;
- the amount and timing of individual projects;
- the in-service data of the resulting assets; and

- the individual components of the assets and the useful lives assigned to those components.

On request, TasWater provided a reconciliation of its Opening RAB calculation. On reviewing TasWater's calculations, the Economic Regulator considers that TasWater is applying a detailed financial accounting approach rather than a high level regulatory approach.

For example, in financial accounting practice, Capex is recognised in an asset under construction account until completed which may take several years. Once completed and in-service, the asset is transferred to the relevant asset group and depreciated according to usual accounting practices. In contrast to financial accounting, under the regulatory accounting framework, Capex is recognised as an asset in the year of expenditure and fifty per cent of that Capex is depreciated by the annual regulated rate. Additionally, under the regulatory accounting framework the calculation of the RAB does not consider the amount of Capex spent on specific projects, the useful lives of the relevant assets or when the project is in-service.

The Economic Regulator also notes that the reconciliation did not take into account the under-delivery of Capex during the first regulatory period. The Economic Regulator was also unable to reconcile the value of delivered Capex (both regulated and total) presented in the reconciliation with the values reported in TasWater's Financial Statements and in the 2013-14 Regulatory Accounts. Application of the two approaches will clearly produce quite different results and, for regulatory purposes, the Economic Regulator considers the methodology it has applied to be the appropriate means of calculating the Opening RAB for 2015-16.

Decision

No change to the Draft Report.

4.4 Third Party Contributions

In its submission, TasWater requests that the Economic Regulator review its treatment of third party contributions as it considers that the Regulator has misinterpreted the nature of TasWater's grant income concerning the State Government subsidies for headworks charges and grants for non-regulated reuse assets. TasWater believes these amounts should be excluded from the total of third party contributions which are deducted from the RAB. TasWater's submission also notes that the amounts in its proposed draft price and service plan were nominal and requests that adjustments be made to ensure all figures are presented on a consistent basis.

Discussion

In effect, TasWater believes that State Government subsidies and grants for unregulated assets should be included in the RAB.

Third party contributions and grants are addressed as part of the regulatory framework in terms of calculating both the RAB and Capex. Third party contributions

are excluded from the RAB because TasWater did not pay for the assets or the portion of assets contributed by the third party and TasWater is not, therefore, entitled to receive a return on those assets neither as a return on capital or as a return of those assets ie depreciation.

To allow TasWater to include third party contributions in its calculation of the RAB and Capex as it has suggested would therefore ultimately lead to higher prices for consumers once prices are determined on the basis of revenue limits rather than price constraints.

The Economic Regulator has reviewed the basis of the third party contributions presented in its Draft Report and has identified minor errors due to incorrect indexing.

Decision

Amend the Draft Report to correct the indexation errors with respect to the calculation of third party contributions.

4.5 Weighted Average Cost of Capital (WACC)

TasWater's submission notes that the Regulator has used a different methodology for determining the risk free rate compared to the methodology used to calculate the debt risk premium.

TasWater contends that its proposed methodology which includes using a trailing average for both the risk free rate and debt risk premium is appropriate in that it reflects "the actual borrowing behaviour of regulated entities" and removes "the volatility associated with financial markets". TasWater defines "trailing average" as the average of the of 10-year and 40-day averages of 10-year Commonwealth Government securities.

TasWater states that its "trailing average" approach is used by two of the major Australian regulators, the Independent Pricing and Regulatory Tribunal (IPART) and the Australian Energy Regulator (AER), acknowledging that "...the AER is transitioning to the full adoption of the methodology".

TasWater considers the Economic Regulator's methodology of not applying the same methodology to both the risk free rate and the debt risk premium ie not incorporating a historical component in the debt risk premium is flawed and requested that the Regulator review its methodology for determining the risk free rate and the debt risk premium.

Discussion

In its proposed price and service plan TasWater calculated the risk free rate and debt premium using the average of the 10-year and 40-day averages of 10-year Commonwealth Government securities and the Reserve Bank of Australia's (RBA) corporate credit spread.

The Economic Regulator's Draft Report did not support the trailing average methodology and used a combination of a daily weighted 10-year average and a 40-day average of 10-year Commonwealth Government Securities and a 40-day average of the RBA's corporate credit spreads.

The Regulator notes that:

- IPART does not use a trailing average but uses a combination of the daily 10-year average and 40-day average of the 10-year Commonwealth Government Securities and RBA's corporate credit spreads to determine the cost of debt;
- other jurisdictional regulators such as the Queensland Competition Authority, Economic Regulatory Authority and the Australian Competition and Consumer Commission do not include a historical component in their calculation of the risk free rate and debt premium and continue to use a point in time methodology; and
- AER has adopted a trailing average but is phasing in the trailing average methodology over a ten year period. The trailing average method assumes a business raises debt annually in ten equal parcels and is an average of the interest rates over ten years. The cost of debt is recalculated each year of the regulatory period therefore requiring prices to be reviewed annually. The AER claims its "...approach leads to a relatively stable estimate over time"².

The Economic Regulator notes that there continues to be a lack of consistency between regulators with respect to determining WACC components particularly in relation to the calculation of the risk free premium and the debt risk premium. The Economic Regulator has therefore decided, for the sake of simplicity, to use the same methodology for both the risk free premium and the debt risk premium ie a combination of weighted average methodology and point in time.

The Regulator notes that the statutory revenue limit will not affect revenue for the second regulatory period as revenue is still constrained by customers transitioning to target tariffs. However, the WACC parameters and WACC calculation methodologies will be re-assessed for the third regulatory period when it is expected that the statutory revenue limit will have a direct impact on water and sewerage prices.

Decision

Amend section 4.4.4 of the Draft Report to reflect the Economic Regulator's decision to use the same methodology for calculating both the risk free premium and the debt risk premium ie a combination of weighted average methodology and point in time.

²<http://www.aer.gov.au/sites/default/files/AER%20Better%20Regulation%20factsheet%20-%20rate%20of%20return%20guideline%20-%20December%202013.pdf>

4.6 Asset Renewal Annuity (ARA)

In its proposed price and service plan TasWater stated that it viewed the ARA as an annualised theoretical calculation of the future asset renewal and replacement program required to maintain the operating capacity of infrastructure assets over the life of the regulated entity. TasWater also considered that the ARA did not need to equal the current and forecast spending allocated to renewals.

TasWater explained that its annuity was based on a “fully regulated asset base” and essentially represented the amount it should be spending on renewals, as opposed to its forecast Capex which, given its need to focus on compliance in the near future, is based on the remaining funds that can be allocated and delivered each year.

As noted in its Draft Report, the Economic Regulator does not accept TasWater’s view or methodology. In particular, the Economic Regulator noted that the inputs into TasWater’s proposed ARA were based on theoretical expenditure which the Economic Regulator contends, based on both Jacobs’ and the Economic Regulator’s review of TasWater’s past Capex, is not practically achievable.

Noting that TasWater proposed an annual combined water and sewerage ARA of \$95 million, in its Draft Report the Economic Regulator calculated an alternative ARA of \$45.031 million on the basis of the expenditure re-profiling and assumptions set out in section 4.4.10 of its Draft Report.

In its submission on the Draft Report TasWater notes that its proposed ARA of \$95.2 million is comparable to the \$80.2 million ARA approved as part of the first regulatory price determination investigation in 2012. TasWater also notes that its proposed ARA value is similar to the depreciation proposed and approved in 2012.

TasWater requested that the Regulator review its methodology and rationale for determining the ARA.

Discussion

In the first instance, the Economic Regulator notes that whereas the ARA is based on estimating the funds required to replace TasWater’s infrastructure assets, depreciation apportions the cost of the assets over their useful lives ie comparing the values for depreciation and the ARA is neither valid nor relevant.

In its submission, TasWater stated that the Economic Regulator’s proposed ARA was incorrect due to the ARA being substantially lower than both the ARA proposed by TasWater for the second regulatory period and the ARA approved during the first pricing investigation. In addition TasWater stated that its ARA was correct as it was similar to its proposed depreciation expense for the second regulatory period.

The Economic Regulator subsequently requested TasWater to provide further justification for its proposed ARA. In response, TasWater submitted additional justification and a revised ARA which reflected a change in the annuity from 30 years to 60 years, and included combined water and sewerage Capex of over \$474 million in 2015-16 which related to the backlog of renewals. The revised

annual combined annuity value of \$95.4 million was slightly higher than the original ARA TasWater submitted in its proposed Price and Service Plan.

The Economic Regulator considered that TasWater's submission raised some valid points about the state of TasWater's infrastructure and the likely timeframes for the required upgrades to that infrastructure to maintain its operating capacity. However, this was not reflected in TasWater providing an expenditure profile relevant to, and consistent with, that narrative

The Economic Regulator considers that TasWater has not provided any compelling justification or evidence to support the adoption of either the ARA proposed in TasWater's price and service plan or TasWater's revised ARA. In particular, TasWater's revised ARA fails to address the specific concerns outlined in the Economic Regulator's Draft Report surrounding TasWater's ability to actually spend the annual Capex amounts, with the change in the annuity from 30 years to 60 years only having a material impact on the annuity value due to the inclusion of the renewal backlog in the first year of the annuity.

Consequently, the Economic Regulator will apply the ARA methodology adopted in its Draft Report in calculating TasWater's annual lower revenue limits for each year of the second regulatory period.

Decision

Amend section 4.4.10 of the Draft Report to clarify the basis for the Economic Regulator's decision with respect to the calculation of TasWater's Asset Renewal Annuity for the second regulatory period.

Further amend section 4.4.10 of the Draft Report to reflect the impact on the calculation of the ARAs of the reduction in the $WACC_{NEW}$ between the Economic Regulator's Draft Report (4.58 per cent) and the Final Report (4.26 per cent).

4.7 Debt Servicing

In its Draft Report, the Economic Regulator accepted TasWater's proposal that unregulated assets represented eight per cent of the value of its total assets.

However, TasWater did not apportion its debt servicing costs to remove the unregulated component.

In its submission, TasWater expressed its support for the Economic Regulator reducing the allowance for debt servicing costs by eight per cent to account for the unregulated component of debt servicing costs as set out in section 4.4.9 of the Draft Report.

Decision

No change to the Draft Report.

4.8 Depreciation

In its submission TasWater notes that the Regulator's combined water and sewerage depreciation for both new and existing assets is \$20 million per annum lower than that proposed by TasWater and \$16 million per annum lower than that approved by the Economic Regulator for the previous regional corporations in 2012 in respect of the first regulatory period.

TasWater's submission notes that although TasWater and the Economic Regulator used the same data, the Economic Regulator used a different approach in determining the average asset life and therefore depreciation value.

TasWater contends that the Economic Regulator's approach is incorrect and states that, in its audit of TasWater's regulatory accounts, the Tasmanian Audit Office supported the methodology used by TasWater in calculating average asset lives.

TasWater also considers a reduction in the depreciation allowance may impact on the business' ability to undertake renewals or a "step-change" in the depreciation allowance may be needed in the next period "once additional data and information has been collected".

Based on the issues raised in its submission, TasWater requested that the Economic Regulator review its methodology for determining asset lives.

Discussion

In its proposed Price and Service Plan TasWater determined asset lives for both new and existing assets based on an average of the depreciation expense for each asset category. However, in its Draft Report the Economic Regulator adopted a value weighted average approach.

The Economic Regulator contends that a value weighted average approach is appropriate and this view is supported through its use by other jurisdictional regulators in both the water sector and in other industries. It is the most appropriate method because of the expected long lives of infrastructure assets and therefore becomes an issue of intergenerational equity where the costs should be borne by both current and future customers as both benefit from the assets.

The Economic Regulator also considers that failing to calculate useful lives on a value weighted average approach gives greater weighting to relatively lower value and shorter life corporate assets at the expense of the much higher value and longer life infrastructure assets.

The Economic Regulator therefore disagrees with TasWater's approach and considers that, if TasWater's approach was adopted, it would be likely to result in step changes in depreciation and consequentially a greater likelihood of future price volatility ie future prices being determined on the basis of revenue limits will be impacted by changes (particularly step changes) in annual depreciation allowances.

In addition to the different approaches to calculating depreciation, the Economic Regulator also further examined the useful lives of TasWater's infrastructure assets by reviewing a copy of TasWater's Asset Register.

The Economic Regulator analysed the register and calculated asset useful lives based on the information reflected in the register. The results of these calculations indicated that the asset useful lives used in the Draft Report (as submitted by TasWater) may be too short, thereby over-stating depreciation. However, the Economic Regulator does not propose to make further adjustments at this time due to the current level of uncertainty about, and therefore confidence associated with, information relating to TasWater's assets. The Economic Regulator considers that the issue of asset useful lives will need to be revisited at the next price determination investigation ie the methodology and underlying data adopted to calculate regulatory depreciation for the second regulatory period should not be seen as setting a precedent for future regulatory periods.

Decision

Amend section 4.4.3 of the Draft Report to clarify the basis for the Economic Regulator's decision with respect to the calculation of TasWater's asset useful lives and regulatory depreciation allowances for the second regulatory period.

4.9 Revenue

Several submitters raised issues about the revenue the previous regional corporations received during 2012-13, the revenue TasWater received during 2013-14 and the revenue TasWater expects to receive during 2014-15.

Nekon Pty Ltd questioned TasWater's higher than forecast revenues and also suggested that the Economic Regulator had not carried out adequate oversight of TasWater's activities.

TasWater considers that the Regulator's conclusion that TasWater will have recovered revenue of some \$80 million in excess of the estimated revenues provided by the former regional corporations in 2012 during the first regulatory period to be based on underlying assumptions and a comparison that is factually inaccurate.

TasWater is also of the view that there will in fact be an under-recovery of revenue in the order of \$3 million for the 2012-15 period when comparing regulated revenue approved by the Regulator in the 2012 determination with the former corporations' and TasWater's actual (and budgeted) regulated revenue. Section 3.1.1 of TasWater's submission provides a summary of its analysis and position on this matter.

TasWater also considered this to be an important issue as the supposed over-recovery of revenue appears to be a key justification used by the Economic Regulator to support its proposal that TasWater should and can afford to increase the pace of the price transition for customers above target beyond what was proposed in its proposed price and service plan.

Discussion

Following the release of the Draft Report the Economic Regulator has reviewed the underlying basis of the analysis reflected in its Draft Report and has found that actual revenue for the first regulatory period was below (or is expected to be below in the case of 2014-15) forecast revenue by a total of \$7.18 million over the period after:

- excluding unregulated revenue;
- adjusting for the inconsistent use of real and nominal values; and
- increasing Southern Water's revenue forecasts for the first regulatory period to account for revenue that had not been accounted for in forecast revenue as part of the 2012 investigation³.

One of the key ways the Regulator has of monitoring TasWater's performance (including the amount of revenue received relative to forecast) is through reviewing the information presented in a regulated entity's regulatory accounts. However, 2013-14 was the first year that regulatory accounts have been submitted, their scheduled submission having been deferred due to the amalgamation of the previous regional corporations⁴.

Revenue for the first regulatory period is being monitored by the Economic Regulator rather than being regulated as price constraints have determined prices not revenue. This situation will continue during the second regulatory period as the price transition is completed. For the third regulatory period, revenue will be regulated and the revenue limits are, therefore, expected to determine prices.

In terms of the Economic Regulator bringing customers paying above the target tariff directly to target on 1 July 2015, the Economic Regulator has considered only the gap between TasWater's forecast revenue for the second regulatory period and the revenue limits in deciding that TasWater has the capacity to bring customers down to target sooner than it proposed in its proposed price and service plan.

Decision

Amend section 5.8.2.2 of the Draft Report to remove the references to revenue over-recovery by TasWater and its predecessors during the first regulatory period.

Amend section 5.8 of the Draft Report to make clear the reasons for the Economic Regulator concluding that TasWater has the capacity to quicken the pace of price transition ie there is a substantial excess of forecast revenue over the Regulator's calculation of the lower revenue limit for the second regulatory period.

³ Supplementary Income - Southern Water, *Price and Service Plan 2012-2015*, page 180.

⁴ TasWater was required to submit regulatory accounts for 2013-14 in accordance with the Economic Regulator's *Water and Sewerage Accounting Ring fencing Guideline* (May 2013).

5 SERVICE PROVISION

5.1 Serviced Land

TasWater and the Tasmanian Government raised the issue of serviced land in their respective submissions. The Tasmanian Government noted its support of the Economic Regulator's proposal to require TasWater to provide an undertaking that the description of serviced land is regularly updated, published and made available to the public. The Tasmanian Government also considered that the Regulator should have the capacity to approve changes to serviced land boundaries within the regulatory period.

TasWater's submission noted that its proposed minimum flow and pressure standards were based on the standards outlined in TasWater's Supplement to the Water Services Association of Australia's *Water Supply Code of Australia*. TasWater's submission supported the Economic Regulator's intention to require the finalised versions of its state-wide serviced land maps to be provided in the final plan as well as an undertaking to make the final version of those maps available to the public from 1 July 2015. TasWater also supported the Economic Regulator's intention to require TasWater to provide an undertaking that the description of serviced land is regularly updated, published and made available to the public. However, TasWater stated that it should only be required to publish updates of the serviced land area on a quarterly basis, to avoid increasing administrative costs.

In its Draft Report, the Economic Regulator requested that each property be shown as either serviced land or unserviced land. In its submission, TasWater stated that whilst it is able to do this, there are benefits to retaining the existing arrangements. Specifically, different levels of service within a property's title boundaries are able to be shown in these cases and this provides land owners with information about the levels of service available at different parts of their property ie in these instances the minimum pressure/flows may not be available at some parts of the property. TasWater therefore considers it appropriate, and good practice, to make property owners aware of such limitations, especially for currently vacant land which may assist with positioning of a future dwelling or other building.

TasWater also proposes updating the terms on the legends for the serviced land maps to ensure consistent terminology is used across TasWater's Price and Service Plan documents and adding an additional category: 'further investigation required'.

Discussion

The Economic Regulator considered that there was a lack of clarity in TasWater's proposed minimum flow and pressure standards and that there was insufficient justification as to why the description of serviced land could not be updated more regularly than quarterly.

The Economic Regulator noted that TasWater's justification of its proposed minimum flow and pressure standards appeared to be valid. The Economic Regulator does however consider that there is still a need for greater clarity and transparency with respect to the standards adopted, especially given that the document which the standards are based on, the Water Services Association of Australia's Water Supply Code of Australia, is not freely available to the Economic Regulator or the public (TasWater's supplement to the code is currently available on TasWater's website).

In relation to the Economic Regulator's capacity to approve changes to serviced land boundaries it is accepted that the Draft Report did not provide sufficient clarity on these arrangements. On that basis it is considered that all increases in serviced land must be made in accordance with the Service Extension and Expansion Policy and/or the Service Introduction Policy which are approved by the Economic Regulator as part of its approval of TasWater's Price and Service Plan. Such increases in serviced land do not require the prior approval of the Economic Regulator. However, TasWater is required to publish regular updates to the descriptions of serviced land. Reductions in serviced land will need to be approved by the Economic Regulator provided such proposals are consistent with the service replacement process set out in section 6.3 of the Final Report.

The Economic Regulator is not satisfied that updating the serviced land area more regularly than quarterly would have a meaningful impact on administrative costs. Specifically, publishing on a quarterly basis could see the description of serviced land out of date for lengthy periods of time (eg if the description of serviced land changed on 31 March details of the change would not be published until the start of the next quarter in July) and may lead to customers making decisions on the basis of outdated information.

The Regulator considers that the need to provide certainty for customers should take precedence. The Regulator therefore intends requiring TasWater to publish updates to serviced land as soon as possible after changes are made and, in any case, on at least a monthly basis.

The Regulator supports TasWater's proposal to allow serviced land boundaries to exist within titles on the basis that it provides additional information to customers.

Decision

Amend section 6.1 of the Draft Report to clarify the processes relating to changes to the description of serviced land.

Further amend section 6.1 of the Draft Report to clarify the basis of TasWater's proposed minimum flow and pressure standards and require TasWater to publish TasWater's Supplement to the Water Services Association of Australia's *Water Supply Code of Australia* together with any other additional relevant information that would assist customers and stakeholders in understanding any service related restrictions that may apply to their property.

Further amend section 6.1 of the Draft Report to permit serviced land boundaries to exist within titles.

5.2 Service Replacement

In its draft Report, the Economic Regulator noted the importance of TasWater following a robust framework when considering whether to replace an existing reticulated service eg replacing a reticulated water supply with water tanks. Accordingly, the Economic Regulator's proposed framework noted that:

- TasWater's final Price and Service Plan should include a series of flowcharts illustrating the service replacement process in detail;
- TasWater should engage with all relevant industry regulators in considering whether service replacement might be a feasible or viable option; and
- the process for seeking amendments to serviced land should commence only when it is established that all property owners have either signed agreements with TasWater or chosen to disengage from the service replacement process.

TasWater was the only submitter in relation to the proposed service replacement framework.

In its submission, TasWater recommended adding to the Economic Regulator's proposed process:

- a new step to reflect the Economic Regulator's approval, prior to individual customers receiving offers from TasWater, for a service replacement proposal to proceed; and
- detail about whether the Economic Regulator considers majority community support is necessary for service replacement to proceed and, if so, whether TasWater has flexibility in determining how support or feasibility/viability is determined.

Discussion

In proposing a detailed service replacement process requiring TasWater to engage with individual property owners before seeking amendments to serviced land, the Economic Regulator's proposed process is designed to provide certainty. As noted in the Draft Report, if the proposed process is followed then regulatory compliance can be achieved. Any "approval" provided by industry regulators prior to individual customers receiving offers, could only be conditional on future actions occurring, which would be contrary to the objective of providing certainty.

As described in the Draft Report, the proposed process already provides for the industry regulators to play an important role in the investigation of the option of service replacement.

In requiring TasWater to engage with all relevant industry regulators as part of the service replacement process, the Economic Regulator's proposed process already

requires those regulators to provide their in-principle support for service replacement being investigated, if service replacement is considered to be an appropriate option. This support may involve, for example, the attendance of regulators at public meetings.

The Economic Regulator considers that adoption of TasWater's suggestion would be counterproductive to the objectives of the proposed service replacement process and the suggested addition is therefore not supported.

As to consultation with the affected community and regulators, the Economic Regulator will need to be satisfied that the level of community consultation involved in analysing options and determining a solution is appropriate for service replacement to proceed. Whilst the Economic Regulator will need to be satisfied that the solution is reasonable it does not intend setting a precise threshold for determining whether or not the level of community support is adequate.

Decision

No change to the Draft Report.

5.3 Customer Service Standards

As outlined in its Draft Report, the Economic Regulator is responsible for regulating standards and conditions of supply of regulated water and sewerage services. This has been undertaken through the specification of minimum service standard targets within the Customer Service Code (the Code) as well as the determination of transitional service standards as part of the Price Determination processes.

TasWater was required to have set and achieved new minimum service standard targets, set on a differential basis, before the conclusion of the third regulatory period (which is scheduled to commence on 1 July 2018). That is, service standards which would reflect the different costs of delivering the regulated services to different geographical areas.

TasWater was responsible for proposing, in its proposed price and service plan for the second regulatory period, the new differential minimum service standard targets that would be included in the Code. In addition, TasWater was to propose transitional service standard targets for each financial year of the second regulatory period to demonstrate how the entity intended to transition towards the minimum service standards it proposed.

TasWater did not, however, propose service standards, nor outlined any associated transition path, on a differential basis. Rather, TasWater proposed state-wide minimum service standards as well as annual transition targets to move to the service standard targets over the second regulatory period.

Under this proposal, in reporting against the level of service standards, TasWater would effectively be continuing to report aggregated performance (ie averaged out across the state).

The Economic Regulator, in its Draft Report, indicated its concern that matters pertaining to differential standards had not been addressed.

To this end, the Economic Regulator proposed to approve the current minimum service standards as outlined Schedule 1 of the Code as actual minimum standards for the second regulatory period. That is, the performance of TasWater against each indicator would no longer be averaged out across TasWater's system state-wide. Rather, the service standard proposed for each indicator would be the absolute minimum standard TasWater must meet, in all instances, and in all of its interactions with customers state-wide, with respect to that indicator.

Discussion

TasWater made the only submission on the Economic Regulator's proposal concerning customer service standards.

In its submission TasWater maintained that averages provide better incentives for businesses to drive efficiency at this stage in TasWater's maturity. And that the consideration of setting actual minimums would possibly drive outcomes that are at odds with the priorities set by the technical regulators and TasWater's legislative obligations.

TasWater also remained concerned about the quality of its data, noting that systems and processes required to fully comprehend its underlying performance do not yet exist. Furthermore, that the entity would be in a better position to provide more accurate and evidence-based customer service standard targets for the next regulatory period.

Nevertheless, TasWater did indicate it would be open to exploring, with the Economic Regulator, the possibility of setting actual minimum standards for some of the indicators.

Subsequent to the closing date for submissions, officers of the Office of the Tasmanian Economic Regulator (OTTER) have held further discussions on this issue with TasWater, with TasWater providing a secondary proposal in relation to customer service standards for the Economic Regulator's consideration.

TasWater's secondary proposal was based on recent analysis of actual performance data for the period 1 July 2014 to 28 February 2015. On the basis of that analysis, and recognising the Economic Regulator's desire to move to actual minimum standards, TasWater identified it was in a better position to propose more accurate and evidence-based customer service standards with respect to 'response time' and 'duration related' indicators and service standards relevant to 'water supply interruptions' and 'sewer breaks and chokes' indicators.

Revised 'actual minimum' service standards for these aforementioned indicators were subsequently provided to the Economic Regulator for its consideration.

In addition, TasWater identified that, whilst a number of its proposed revised service standards would be met, as per its newly proposed transition path, over the second

regulatory period, response time and duration related indicators would only be achieved 'X' per cent of the time over that same period (specifically 80 or 90 per cent of the time).

The Economic Regulator accepts that the alternate proposal presented by TasWater represents a movement in the right direction towards service standards that are meaningful to customers.

Decision

Amend Chapter 7 of the Draft Report to reflect TasWater's alternate proposal with respect to customer service standards.

The approved customer service standards to apply for the second regulatory period will subsequently be implemented by the Economic Regulator by way of the Code change process.

5.4 Customer Contract and Policies

As discussed in the Economic Regulator's Draft Report, TasWater is required, under various legislative and regulatory instruments, to have included in its proposed price and service plan a series of draft policies and a draft customer contract. The policies required to be provided are listed as follows:

- Connection policy;
- Service charges;
- Service extension and expansion policy;
- Service introduction charges policy;
- Developer charges policy;
- Sub-metering policy;
- Trade waste charges policy; and
- all other policies relating to TasWater's interactions with customers and potential customers (which included, in this instance, TasWater's 'financial hardship policy' and its 'customer complaints, enquiries and disputes management policy').

With the exception of the developer charges and sub metering policies, the Economic Regulator assessed the draft customer contract and the draft policies listed above as part of its price determination investigation. As noted in its Draft Report, the Economic Regulator focussed on compliance and accuracy ie the Economic Regulator was concerned only with non-compliance matters/errors in the draft customer contract and draft policies including drafting errors which have the effect of rendering the documents non-compliant.

The review of the draft developer charges policy included in TasWater's proposed price and service plan was deferred pending post Draft Report discussions with TasWater and the Economic Regulator's consideration of submissions received relating to developer charges. The sub-metering policy is discussed separately in Section 5.5.

In its Draft Report, the Regulator indicated its intention to 'require' TasWater to address all non-compliance related matters by re-drafting the draft customer contract and remaining draft policies (as set out in chapter 6 of the Draft Report).

Of the submissions received, only those from TasCOSS and Anglicare Tasmania touched on matters pertaining to the compliance of the draft customer contract and draft policy documents.

TasCOSS indicated concern that some of TasWater's customer service policies were non-compliant. Anglicare Tasmania noted similar concerns and indicated support for the Economic Regulator's approach to ensure that TasWater's policies are legally effective, comply with the relevant regulatory and legislative provisions, are easily understood by the reader and are consistent in structure and terminology.

In addition, and specifically in relation to TasWater's financial hardship policy, Anglicare Tasmania suggested that:

- TasWater should waive one payment after four payments have been made by a person in hardship, rather than the five proposed in their hardship policy; and
- TasWater should establish a hardship fund delivered by their community service obligations.

Discussion

It is the *Water and Sewerage Industry (Customer Service Standards) Regulations 2009* which set out high level requirements for the inclusion of financial hardship provisions in the Customer Service Code and which requires a regulated entity (TasWater in this instance) to have and apply a financial hardship policy to customers who are suffering 'financial hardship'. The Regulations also outline the 'criteria' that a customer is to meet to be deemed suffering financial hardship. The Regulations also state what the Customer Service Code must specify in terms of what is to be contained/outlined in a regulated entity's financial hardship policy.

The Regulations, and subsequently the Customer Service Code, do not, however, dictate to the regulated entity the lower level 'terms' of its financial hardship policy with respect to, for example, flexible payment options, any instalment plans, waivers or incentives, or payment extensions. These are matters that are entirely at the discretion of a regulated entity in the development and drafting of its policy and the Economic Regulator suggests that Anglicare Tasmania should bring these issues to TasWater's direct attention.

In conclusion, the matters raised in the submissions from TasCOSS and Anglicare Tasmania, with respect to the compliance and accuracy of TasWater's draft policies and draft customer contract, will not result in any amendments to the Economic Regulator's position as already outlined in its Draft Report.

Decision

The Economic Regulator will continue to work with TasWater to progress the customer contract and policy documents to 'final/compliant' status in preparation for their inclusion in TasWater's final price and service plan.

5.5 Sub-Metering Policy

After submitting a generic metering policy as part of its proposed price and service plan, TasWater subsequently provided a standalone sub-metering policy as required under the Economic Regulator's Price and Service Plan Guideline November 2013 in its submission. TasWater stated it intended to continue the sub-metering approach that applied during the first regulatory period.

Mr Mark Loveridge contends in his submission that the water service charges imposed on his strata titled property are incorrect. Specifically, the current water service charge for each lot is greater than the water service charge for strata title property boundary meter divided equally between lot owners. Mr Loveridge considers the following changes need to be made in respect of strata titled properties:

- where there is only a boundary meter the water service charge for the boundary meter should be apportioned on unit entitlements;
- reimburse lot owners who have been overcharged;
- TasWater should only send one bill to each body corporate who would then apportion the bill among lot owners;
- sub-meters of an approved standard should be able to be bought and installed privately therefore allowing any or all lot owners to sub-meter;
- sewerage charges should be billed on a similar basis ie a single bill sent to the body corporate;
- concessions should continue to apply; and
- customers who implement water-saving measures, including rainwater capture, should be rewarded through reduced bills and a permanent concession as an offset to the individuals cost of implementing water saving measures as this these measures reduce TasWater's long-term infrastructure needs.

Mr John Mills' submission expressed concern that the seven strata schemes that comprise the complex known as "Redwood Village" in Kingston are not being metered according to TasWater's current sub-metering policy. Mr Mills states that

the pipe work at “Redwood Village”, which was initially developed as a single strata scheme, was designed to accommodate further expansion. The existing pipe work is therefore not sized for the individual strata schemes (ie it is over-sized relative to current requirements). As a consequence Mr Mills claims that lot owners in the complex are disadvantaged because of the configuration and size of the pipe work eg a number of schemes have multiple meters resulting in lot owners paying higher fixed charges than if one boundary meter had been used for each strata scheme.

Mr Mills also states that TasWater is incorrectly charging lot owners for fire services with each strata scheme being charged for a 100mm fire services connection.

Discussion

Based on anecdotal evidence the Economic Regulator considers that there was, and continues to be, a lack of clarity about sub-metering, resulting in part from TasWater (and prior to TasWater’s commencement, the three regional corporations) apparently misinforming customers as to what was involved in sub-metering. In addition, the sub-metering policy in force during the first regulatory period did not address all possible metering arrangements, or when and how fire services charges would be applied to strata schemes.

The Economic Regulator provided TasWater with comments and suggestions on the following issues regarding sub-metering:

- the requirement for meters to be installed in respect of common property;
- the processes and procedures surrounding sub-metering;
- the application of concessions;
- the ability to bill a body corporate and not individual lot owners;
- the lack of information and clarity regarding multi-unit properties;
- the requirement for clarity regarding total costs associated with sub-metering;
- the approach to existing strata schemes and the whether an optimised approach is appropriate; and
- the ability to vary the unit entitlement for billing purposes.

The Economic Regulator will continue to work with TasWater on refining its draft sub-metering policy to ensure it meets legislative requirements and provides clarity and certainty for stakeholders prior to its inclusion in TasWater’s final price and service plan.

Decision

Amend section 6.2.4 of the Draft Report to require TasWater to provide undertakings to develop and make available supporting documentation that will set out a high level description of the process and procedure to be followed by strata

title owners in deciding whether or not to install sub-meters and to publish all relevant sub-metering documentation on its website.

Further amend section 6.2.4 of the Draft Report to require a combination of TasWater's sub-metering policy and TasWater's supporting documentation relating to sub-metering to address the issues listed in section 5.5 of this Statement of Reasons.

6 PRICING AND PRICE REFORM APPROACH

In its submission, TasWater expressed support for the Regulator's intention to approve the proposals contained within TasWater's proposed price and service plan in relation to:

- the adoption of postage stamp pricing;
- customer classes; and
- the basis for pricing of:
 - fixed water target tariffs;
 - limited supply customers;
 - fire service customers;
 - fixed sewerage charges;
 - variable water charges;
 - private and public filling stations;
 - trade waste;
 - motor home dump points;
 - miscellaneous fees and charges; and
 - development assessment services fees.

6.1 Fixed/Variable Price Split

In her submission on fixed/variable split of water service charges, Ms Carington-Smith stated that her water fixed/variable charges up until then had been split 76/24 (respectively) and that the low relative variable charge was not creating a significant incentive to use less water.

TasCOSS made a similar argument in its submission. TasCOSS believes that the high proportion of fixed to variable costs makes it difficult for households to save money by reducing their water usage. TasCOSS also argues that the fixed/variable charge split distorts the price signal to consumers and does not provide any incentive to conserve water. TasCOSS believes that the current split is in place primarily to ensure TasWater has a stable and predictable revenue stream.

Discussion

The majority of the costs associated with providing water and sewerage services are fixed. Lowering the fixed charge and recovering fixed costs through an increased variable charge would result in large water user customers (such as industrial customers, hospitals and schools) subsidising low use customers (residences, car parks and office blocks). This would have create a cross subsidy and be inconsistent with cost reflective pricing.

As discussed in section 5.3.11 of the Draft Report and as permitted by Regulation 16 of the *Water and Sewerage Industry (Pricing and Related Matters) Regulations 2011*, the Economic Regulator proposed allowing for some fixed costs to be recovered from variable costs during the second regulatory period as part of the transition to cost reflective pricing.

Whilst this is not desirable in the longer term, the Economic Regulator considers it appropriate for TasWater to set variable charges above variable costs to attempt to moderate demand and enable it to defer demand driven capital investment, thereby allowing regulatory compliance improvement investment to continue to occur.

Decision

No action required.

6.2 Fixed Water Charges

In its submission, TasWater considers the Regulator's proposal to set target water fixed charges at TasWater's proposed 2017-18 rate (\$329.48) for each year of the period to be inappropriate. TasWater believes that because this is the first regulatory period for TasWater as a statewide provider it "is the best time to reset prices that take account of the benefits associated with having one business which is in turn reflected in a continued price transition journey for customers".

TasWater believes that a flat target risks sending the wrong message to consumers when target prices are likely to need to increase again in the future. TasWater also noted that the Economic Regulator's proposal will result in an increase to customers on the fixed tariff in the south of approximately eight per cent.

In his submission, Mr Peter Rooke considered that the service charge based on pipe size should be removed because usage is billed ie a user pays principle should be adopted.

Discussion

The Economic Regulator doesn't consider TasWater's argument against a flat target rate to be compelling or that it will be simpler for TasWater to explain its proposed fixed water charges to customers.

The Economic Regulator considers that a flat target rate is simpler for customers to understand and therefore reaffirms the proposal set out in the Draft Report to

require TasWater to apply its proposed 2017-18 fixed water target tariff as a flat target rate for each financial year of the second regulatory period.

In terms of the issues raised by Mr Rooke, the Economic Regulator notes that the Industry Act requires prices to be cost reflective and that the majority of the costs associated with providing water and sewerage services are fixed.

Additionally, properties serviced by larger diameter pipes, such as multi-dwelling properties, industrial customers and schools, have the potential to place a larger demand on the system. On that basis, the Economic Regulator considers it appropriate that a larger fixed charge is levied on these properties.

Decision

No change to the Draft Report.

6.3 Variable Water Charges

Submissions from Mr Geoff Kennedy, TasCOSS and TasWater commented on several aspects of the proposed charging for water usage.

Mr Kennedy believes that it is unfair that some customers have been paying a higher variable charge than others for the same service for as long as they have.

TasCOSS expressed its support for variable water charges being indexed during the second regulatory period to account for inflation.

TasWater noted that the Economic Regulator's Draft Report incorrectly states, on pages XIV and 74, that TasWater's proposed variable water charge for 2015-16 is \$0.9471 per kilolitre whereas TasWater's proposed variable water charge for 2015-16 is actually \$0.9711 per kilolitre.

Discussion

The transition to cost reflective pricing and full application of the pricing principles requires a transition period in which some customers may have to pay more than others for the same service. In relation to variable water charges during the first regulatory period, customers in a number of north-west coast council areas have been paying variable water charges that are significantly below target. This occurred mainly due to the requirement to remove substantial free water allowances that had historically been provided by councils in those areas. During the first regulatory period the variable water charges for these customers have been transitioning up to target.

This transition period has been necessary to avoid prices shocks caused by significant price changes impacting on those customers.

In the case of variable charges, TasWater has proposed, and the Economic Regulator has agreed to, transitioning variable charges for customers paying below target to target in three equal instalments over the second regulatory period. The

Economic Regulator considers that this approach is appropriate in balancing the competing objectives the Economic Regulator is required to take into account.

The Economic Regulator acknowledges that pages XIV and 74 of its Draft Report referred to the incorrect proposed variable water charge for 2015-16.

Decision

Amend the Draft Report to refer to the correct variable water charge for 2015-16 of \$0.9711 per kilolitre.

6.4 Fixed Sewerage Charges

In its submission, TasCOSS argued that the target tariff for fixed sewerage charges increasing at a rate of six per cent per year is high and that it looks forward to sewerage costs in the future being stable or being indexed only by CPI.

Discussion

The Economic Regulator considers that increasing prices at a rate lower than the proposed percentage will not allow TasWater to earn sufficient revenue to become financially sustainable and fund the significant Capex required to address non-compliance with regulatory requirements and would also prevent the reforms necessary to achieve equitable cost reflective pricing.

The extent of any further price increases in subsequent regulatory periods is a matter for future price determination investigations.

Decision

No change to the Draft Report.

6.5 Equivalent Tenements

Submissions from Ms Carington-Smith, a submitter that asked for their name to be withheld, Aged and Community Services Tasmania (ACST), Caravanning Tasmania and TasWater commented on various aspects of TasWater's equivalent tenement (ET) policy. Several submissions criticised the basis on which an ET is calculated and argued that an alternative method of calculation should be used such as sewerage meters or a calculation based on water usage.

Ms Carington-Smith believes that the ET methodology is unfair as large family homes occupied by large families and small units occupied by lone persons would both be assessed as one ET. Ms Carington-Smith recommends that sewerage charges should be variable and based on the quantity of water used or a two-part pricing system should be introduced as with water.

The submitter that asked for their name to be withheld argues that TasWater needs to better explain and also reassess its ET methodology and believes the assessment process is flawed in that commercial properties are being incorrectly

assessed. They also argued that the onus should be on TasWater, not the customer, to identify mistakes in ET assessments or billing.

In its submission, Aged and Community Services Tasmania (ACST) stated that it believed that aged care ET calculations should be modified so that a single ensuite room is only assessed as 0.3ET (as opposed to the current 0.45ET), as an ET is based on a two to three room residence occupied by an average of 3.5 persons; there are efficiencies in laundry and catering; and older persons are less likely to shower and more like to use incontinence aids.

The caravan park industry has long-standing issues with TasWater's ET methodology, which continue to be subject to ongoing discussions. In its submission, Caravanning Tasmania stated that the uncertainty around this issue is causing damage to the industry as operators are delaying investment.

Caravanning Tasmania recommended that sewerage charges be calculated by multiplying water usage by 0.7 based on research done by Caravanning Tasmania this reflects a realistic amount of sewerage which might be discharged.

Caravanning Tasmania also noted that a different system is used for warehouse space compared to other businesses, so a third system could be implemented for caravan parks. The same result could also be achieved under the ET system by relating the discharge amount to the 160kl allowed in one ET. As the current composition of one ET includes a 20mm connection charge, this method would also require a discount factor to ensure that only one connection fee is charged per site.

TasWater stated that a clear explanation of the ET methodology used to calculate the various ET rates will be included in the final plan and that this information should be published on TasWater's website through the regulatory period.

TasWater had not reached agreement with Caravanning Tasmania of the calculation of ETs for caravan parks. However TasWater was supportive of further discussions between itself, Caravanning Tasmania and the Economic Regulator.

Discussion

The calculation basis of an ET does not take into account the number of people living in or using a property ie the methodology is designed to provide an estimate of the average discharge of sewerage from a residential property.

TasWater has discretion as to whether or not to impose a variable charge for sewerage services. Since the reform of the water and sewerage industry, the previous regional corporations and now TasWater have elected not to include a variable pricing component in the sewerage service charge, instead utilising the fixed charge to cover costs associated with the treatment and disposal of domestic wastewater. TasWater does not consider it practical or effective to meter all sewerage connections.

The Regulator intends to require TasWater to justify any departures in its ET methodology from the schedules contained in the Section 64 Determinations of

Equivalent Tenements Guidelines (which TasWater bases its ET methodology on) and to publish documentation that is not publicly available that TasWater is intending to rely on.

In the event a customer believes their assessed sewerage equivalent tenement (ET) is incorrect they may apply for their ET to be reassessed. Having been contacted by a customer by phone or email, TasWater will then make contact directly to seek further documented evidence and/or organise a site visit. The Economic Regulator considers TasWater's ET assessment review process to be appropriate.

Having discussed issues surrounding caravan parks with both TasWater and Caravanning Tasmania, the Economic Regulator shares some of Caravanning Tasmania's concerns about the proposed application of the ET methodology to caravan parks. That is, due to the variety of caravan parks and facilities across the State, the ET methodology in its current form cannot accurately be applied to caravan parks in Tasmania without a considerable effort by TasWater to ascertain, and maintain records of, the facilities at each park and specific usage patterns. This approach would seem to place a significant administrative burden upon TasWater.

The Economic Regulator noted the suggestion from Caravanning Tasmania that, instead of applying the proposed ET methodology, a discharge factor could be applied to each caravan parks' annual water bill to determine the annual sewerage bill. Whilst the Economic Regulator recognises that this method has merit from a simplicity perspective, it fails to accurately take into account the different fixed and variable costs associated with providing water and sewerage services. Additionally, this approach involves an abandonment of the ET methodology, which may create precedents in terms of customers in other industries.

With the objectives of addressing Caravanning Tasmania's concerns whilst at the same time introducing an approach that is both cost-reflective and administratively simple, the Economic Regulator will require TasWater to adopt the following approach for the second regulatory period to determine ETs for caravan parks each year:

Caravan park ETs = (previous year Q3 to Q3 annual water consumption x discharge factor)/average annual residential water consumption

Where:

- the discharge factor is 0.75⁵; and
- average annual residential water consumption for the preceding financial year based on TasWater's annual performance report (for example, TasWater reported average annual residential water consumption of 185.6kL in its TasWater's 2013-14 performance report).

The standard ET assessment process would then apply to the calculated figure as it does for other customers in terms of value and transition arrangements.

⁵ Based on the findings from Independent Pricing and Regulatory Tribunal, Water - Discussion Paper: *Discharge factors for non-residential customers - Towards a standardised approach*, September 2013.

Based on the currently available information, the Economic Regulator does not think that its proposed approach will have a significant revenue impact on customers for the second regulatory period as the ET calculations will be determining targets that the Economic Regulator understands are unlikely to be reached during the period ie the actual price transition will be the same in PSP2 based on proposed price caps.

With respect to the issues raised by ACST, the Economic Regulator recognise that aged care operators' income per resident is capped (generally at 85 per cent of the aged pension) such that increases in utility prices such as water and sewerage charges are difficult to manage and generally have to be absorbed by the operator. However, the Economic Regulator also notes that ETs for aged care facilities have already been reduced from 0.97 to 0.45 and that this lower ET value is in line with ETs applied by water and sewerage providers in other Australian jurisdictions. On this basis the Economic Regulator does not consider that there is a compelling argument to approve a further lowering of ETs for aged care facilities.

Decision

Amend section 5.3.7 of the Draft Report to reflect the adoption of the Economic Regulator's alternate approach to determining caravan park ETs.

6.6 Motor Home Dump Points

In its submission, Caravanning Tasmania expressed concerns about the proposed charges for dump points. The proposed charge of 1ET per dump point does not specify if this applies to dump points outside of caravan parks or all dump points, including those inside caravan parks.

In explaining its proposed dump point charge, TasWater has advised the Economic Regulator that it has based its calculations on information collected in 2009⁶ in respect of vehicles staying outside commercial caravan parks. Caravanning Tasmania therefore considers that the proposed charge should not apply to commercial caravan parks.

If the dump point charge is to be applied to dump points located within caravan parks, Caravanning Tasmania contends that there shouldn't be any additional charge for this service as any use of these facilities relates to sewerage that would normally enter the system via the communal ablutions block ie the dump point is not receiving sewerage over and above the volume discharged to the network by caravan park users. Caravanning Tasmania also noted that self contained vehicles using commercial caravan parks do so for the convenience of the facilities provided, including communal ablutions. Caravanning Tasmania argues that any additional charge would be a case of "double dipping" on the part of TasWater.

⁶ Tourism Tasmania, *Caravan and Holiday Park Market Snapshot*, October 2009.

Discussion

Having further discussed this issue with both TasWater and Caravanning Tasmania, the Economic Regulator considers that motor home dump points located within a caravan park should not be subject to separate and additional charges ie charging for these services is already covered in the caravan park's ET assessment. The Economic Regulator also considers that separate charges should continue to apply to motor home dump points located outside caravan parks.

Decision

Amend section 5.3.16 of the Draft Report so as the approved motor home dump point charges for the second regulatory period apply only to dump points located outside caravan parks.

6.7 Trade Waste

Submissions from Edgewater Hotel (Michael Wyett); a submitter who asked that their name be withheld; R & G Whiteway and the Tasmanian Government commented on various aspects of TasWater's trade waste charging and the associated trade waste policy.

Mr Wyett noted that the 'trade waste discharge factor' which has been established to calculate the increase in trade waste water tariffs for given industry groups does not allow for hospitality businesses that include accommodation (ie these businesses do not fit into either hotels (EF02 – 25%) or restaurants (MP01 - 50%).

The submitter who asked that their name be withheld stated that they considered it best practice for the utility to charge the tenant rather than property owner and that TasWater need to provide more detail on the differences between category one and category two customers and how these are calculated. This submitter also argued that TasWater needs to provide more evidence of how trade waste charges reflect costs and stated that the proposed section 60 trade waste consent form is confusing and needs to be re-worded to be more customer friendly.

In its submission, the Tasmanian Government commented that it did not consider TasWater's proposed trade waste policy to be sufficiently transparent.

The Government also supported an increase in the level of detailed information that TasWater provides on trade waste matter on its website such that:

- customers can self-identify their category;
- criteria for acceptable discharge for different categories are defined;
- tariffs for each category are clearly set out; and
- available options, such as the pre-treatment, are explained.

R & S Whiteway stated that trade waste charges are too high and that the way customers are categorised is unclear. R & S Whiteway also believed that TasWater

are 'double-dipping' on charges as it charges for trade waste, but also charges waste removal companies that take waste to TasWater's treatment plants.

Discussion

The Economic Regulator understands that the trade waste discharge factor is a percentage of metered water consumption which is considered to be representative of the trade waste discharged to the sewer. Based on the assumption that the volume of water measured through a property meter includes both a trade waste and domestic portion, the trade waste discharge factor is applied to the base volume to represent the typical volume of trade waste expected to be discharged dependent on the business activity.

TasWater advised that it has adopted discharge factors from the NSW Department of Water and Energy (April 2009) – *Liquid Trade Waste Regulation Guidelines*. These discharge factors have been directly matched to the relevant trade waste activities used by TasWater where applicable. However, in some cases, a direct match may not be available, or additional assumptions may have been made in determining the discharge factors. In these instances the Economic Regulator will require TasWater to disclose details of the departures from the *Liquid Trade Waste Regulation Guidelines* together with the reasons for the adoption of the revised factors.

TasWater has also undertaken to investigate and collect additional data during the second regulatory period to improve the accuracy of the trade waste discharge factors.

TasWater acknowledges that a small portion of its customer base may feel that the proposed methodology for determining their trade waste volume does not represent their actual discharge, particularly where sites have multiple uses, some of which do not generate trade waste.

TasWater manages the discharge of trade waste in accordance with the *Water and Sewerage Industry Act 2008* (the Industry Act). Section 3 of that Act defines a customer to include the owner, the owner and occupier or the occupier. TasWater has advised the Regulator that it has chosen to use an owner based system as opposed to billing tenants directly for the following reasons:

- lower resourcing requirements to manage (simplified compliance, fixed charges and less re-engagement each time a business is sold);
- reduced administrative burden on small business ie the turnover of customers requiring database and trade waste contract changes is reduced because properties do not change ownership as regularly as tenants change in the business;
- increased revenue security (lower proportion of bad debts associated with tenants vacating without notification);
- aligns with TasWater's current water and sewerage billing arrangements;

- compliance requirements (pre-treatment devices) are (mostly) fixed assets which stay with the property when the occupier leaves, therefore the owner keeps assets; and
- charges are fixed tariffs which mean tenants actions have limited if any impact on the charges.

TasWater has also advised the Economic Regulator that the section 60 consent form is largely unchanged from the format and content approved by the Economic Regulator for the first regulatory period with only minor changes which TasWater believed made it clearer for the customer to understand. In particular, TasWater notes that it has:

- maintained the conditions from the first section 60 consent from the first regulatory period with only slight amendments to the wording of conditions to make them more easily understood by customers; and
- added Schedule 1 to provide customers with a single page reference to the critical elements of the consent which require management ie pre-treatment equipment details, maintenance frequency and any special conditions if applicable.

In terms of the transparency of TasWater's trade waste arrangements, the Economic Regulator intends to require TasWater to provide, on its website, a final version of its Trade Waste Category Calculator so that it is available to trade waste customers and the public generally; and that the Trade Waste Category Calculator links to relevant policies and other supporting materials released by TasWater in relation to trade waste to assist customers in understanding their trade waste obligations and in undertaking the self-assessment process. The Economic Regulator also intends to require TasWater to clearly outline, and publish, the methodology on which it has based its trade waste customer categorisation in its trade waste charges policy. The Economic Regulator recognises that trade waste discharge has a more significant impact on sewerage infrastructure than domestic waste and that TasWater's trade waste charges are intended to be cost reflective ie the charges should fully recover the costs of providing trade waste services on an equitable basis, including the cost of conveyance, treatment and disposal, and maintenance and repair of damage to the sewerage system.

The Economic Regulator considers that once TasWater makes the Trade Waste Category Calculator and an outline of the methodology on which it has based its trade waste customer categorisation publically available, there will be sufficient transparency in place regarding the trade waste mechanism and no further action will be required.

The Economic Regulator does not consider that TasWater is 'double dipping' with respect to trade waste transported to its treatment plants ie these charges reflect the treatment of the trade waste whereas standard trade waste charges cover both transport and treatment.

TasWater also clarified that tankered waste is concentrated and often sourced from pre-treatment equipment (such as grease traps) that are designed and required to remove the highly polluted waste prior to discharge to sewer. The tankered waste received is therefore highly concentrated and requires TasWater's WWTP to be capable of managing any risks associated with accepting that waste ie TasWater's proposed tankered waste charges are intended to cover the costs of treating the by-products of the pre-treatment of trade waste.

Decision

Amend section 6.2.6 of the Draft Report to require TasWater to disclose details of any instances where it has departed from the discharge factors specified in the NSW Department of Water and Energy (April 2009) – *Liquid Trade Waste Regulation Guidelines* together with the justification for the adoption of the revised factors.

6.8 Miscellaneous Fees and Charges

In its submission, TasWater identified a transposition error in Table 5.8 of the Regulator's draft report regarding the proposed charges for a 20mm meter supply and installation. The charges as proposed in TasWater's draft plan are \$253.86 for 2015-16, \$260.21 for 2016-17 and \$266.72 for 2017-18.

TasWater also revised its forecast of miscellaneous transactions on the basis of the actual number of transactions for the first half of the 2014-15 year extrapolated out for a full year. The forecasts were revised in response to issues raised about these forecasts in the Regulator's Draft Report (the revised forecasts are to replace those set out in Table 5.14 of the Draft Report).

TasWater's submission also points out that Table 5.8 of the Draft Report incorrectly references the standard 100mm sewerage connection charge as the charge for a 20mm (water) meter supply and installation.

Discussion

Although the Economic Regulator notes that some of TasWater's forecasts have changed markedly from those submitted in its proposed price and service plan (eg there are 30 times as many section 56ZQ requests and six times as many restriction charges forecast) TasWater states that the revenue impact from applying these revised forecasts is less than \$200 000 additional revenue per annum. Given the relatively low per unit prices associated with these services the Economic Regulator intends accepting the revised forecasts and requiring TasWater's price and service plan to reflect the revised forecasts.

The Economic Regulator acknowledges that Table 5.8 of its Draft Report did not correctly reflect TasWater's proposed charges for the supply and installation of a 20mm water meter.

Decision

Amend Table 5.8 in section 5.4 of the Draft Report to correct the errors identified in Table 5.8.

Amend Table 5.14 in section 5.5.3 of the Draft Report to reflect the revised forecasts of the number of miscellaneous transactions.

6.9 Service Charges

Ms Carington-Smith's submission on service charges stated that she believes that landowners should not be subjected to service charges for unconnected properties if they already owned the land prior to TasWater installing infrastructure in their area.

Discussion

The Draft Report contains a detailed consideration of the arguments for and against the imposition of service charges including the scenario raised by Ms Carington-Smith's submission.

Decision

No change to the Draft Report.

6.10 Development Assessment Services Charges

TasWater submitted that the table on page 93 of its proposed Price and Service Plan incorrectly referenced Equivalent Population (EP) as the basis for setting the classification thresholds. Whilst Appendix A of the Water Services Association of Australia – Sewerage Code 2002 defines Equivalent Population, TasWater's supplement to that Code (a copy of which is available on TasWater's website) replaces EPs with Equivalent Tenements (ETs).

TasWater's submission also provided a replacement Table 5.10 correcting these references.

Discussion

The Economic Regulator notes that the text of Table 5.10 is unchanged apart from replacing references to EPs with references to ETs and considers that this amendment is appropriate.

Decision

Amend section 5.4.2 of the Draft Report to reflect the replacement of the references to EPs with references to ETs and require TasWater's final Price and Service Plan to reflect the revised development assessment criteria.

6.11 Moving Customers Directly to Target

TasWater's proposed price and service plan outlined a number of circumstances where it proposed either moving customers directly to target or transitioning customers to target. The Economic Regulator's Draft Report outlined a number of concerns the Economic Regulator held about both the list of circumstances and the explanations provided to justify TasWater's proposed treatment of the various circumstances. TasWater's submission acknowledged that its proposed price and service plan did not clearly explain the basis for customers either being moved directly to target or transitioning to target. In its submission, TasWater further advised that customers will be moved directly to target tariffs where there has been a change in:

- the customer at the property;
- the property through a development process including reconfiguration and change of use; or
- the connection or service including the installation of sub-meters.

Discussion

Whilst an improvement over the information presented in TasWater's proposed price and service plan, the Economic Regulator still considered that TasWater's submission described a number of the circumstances using technical terms and some of the scenarios appeared to overlap such that it would be difficult for affected customers to assess whether their liability would change. The Economic Regulator also noted that the proposed treatment of fire service customers, trade waste customers and customers with discovered connections needed to be clarified.

The Economic Regulator has liaised further with TasWater to resolve the above issues which has led to the development of a revised table setting out the circumstances under which customers will either be moved directly to target or be transitioned to target.

Decision

Amend section 5.3.17 of the Draft Report to reflect the outcomes of the Economic Regulator's discussions with TasWater on the circumstances where customers may either move directly to, or transition to, target tariffs.

6.12 Transition to Target for Customers Paying Above Target

TasWater's submission raised concerns about the impacts on the sustainability of its business should the Economic Regulator's proposal to transition all customers paying above target directly to target on 1 July 2015 be implemented.

TasWater has modelled the Economic Regulator's price transition proposal and has found that it reduces TasWater's revenues by \$36.902 million over the 2015-18 period, with the majority of the reduction in revenue (\$19.779 million) occurring in 2015-16. This in-turn leads to 2015-16 net profit after tax (NPAT) decreasing by

\$11.813 million (or 40.2 per cent) compared to the expected NPAT for 2014-15. The cumulative effect of this is to:

- decrease year 10 NPAT by \$9.713 million (or 21.3 per cent);
- increase borrowings over the period by \$96.767 million (or 18.6 per cent); and
- increase the gearing level from 30.4 per cent to 38.3 per cent.

TasWater also argued that its preliminary analysis indicates that the reduction in revenue will lead to:

- a write down in assets of approximately \$100 million at 30 June 2015;
- TasWater reporting a significant after tax loss;
- the elimination of all of TasWater's retained earnings balance;
- dividends (if paid) not being underpinned by a positive retained earnings balance; and
- a potential negative impact on TasWater's credit rating.

TasWater also claims that the Economic Regulator's proposal would affect TasWater's overall business sustainability in that it would not be able to fulfil the following objectives set out in sections 6(1)(c)(i) and 6(1)(c)(ii) of the *Water and Sewerage Corporation Act 2012*:

- (c) to be a successful business and, to this end –
 - (i) to operate its activities in accordance with good commercial practice; and
 - (ii) to deliver sustainable returns to its members; and

TasWater also stated that the Economic Regulator's proposal would adversely impact upon its ability to fund major capital projects in future regulatory periods.

TasWater has also referred to the average gearing ratio of 45 per cent for other Australian water utilities and notes that for established and mature utilities such as Sydney Water, Queensland Urban Utilities, Hunter Water and Yarra Valley Water the gearing ratio is between 35 and 50 per cent.

In its submission, TasWater stated that it did not consider it prudent to make policy decisions that leave TasWater with a high gearing level that would not be commensurate with the business' counterparts in other states (noting TasWater's relative immaturity).

A total of 15 submissions supported the Economic Regulator's proposal to move customers paying above target directly to target tariffs as quickly as possible. A number of submissions also commented about the inequity of customers living nearby paying different prices for the same service from the same company.

Discussion

When assessing TasWater's sustainability the Regulator is required to focus on TasWater's regulated revenue relative to the three revenue limits ie the Economic Regulator is not specifically required to consider TasWater's NPAT, its debt and gearing situation or its capacity to make returns to owners.

The question as to whether TasWater writes down the value of its assets due to the proposed reduction in regulated revenue is an issue wholly within TasWater's control based on its view of its future revenue. For example, fixed charges for the third regulatory period could be proposed to continue to increase at six per cent per annum as has occurred for the first and second regulatory periods should it be decided that additional revenue is required rather than the rate of increase being reduced in future regulatory periods as TasWater has suggested in its proposed price and service plan.

According to the Tasmanian Audit Office⁷, TasWater's gearing as at 30 June 2014 was 21.7 per cent. Compared to mature/compliant mainland providers such as Sydney Water (50 per cent), this gearing ratio is low. Additionally, in ten years time TasWater will have been in existence for some 12 years and will no longer be seen as an immature business and, with the expected delivery of significant compliance improvement projects, TasWater is also expected to have far higher levels of compliance with environmental and public health obligations than is currently the case ie the expectation is that TasWater's compliance levels would at the very least be trending up towards the compliance levels of mainland providers.

The Economic Regulator remains of the view that the approved pricing arrangements for the second regulatory period will be sufficient to fund TasWater's planned Capex for this upcoming period. Additionally, the funding of major capital projects beyond the second regulatory period will be considered by the Economic Regulator as part of future water and sewerage price determination investigations.

The Economic Regulator has no role to play in respect of dividends and is not responsible for the administration of the *Water and Sewerage Corporation Act 2012* ie it is up to TasWater's Board to determine TasWater's dividend policy.

Decision

No change to the Draft Report.

6.13 Transition to Target for Customers Paying Below Target

Submissions from Redline Coaches, the Tasmanian Government, Anglicare and TasCOSS expressed support for TasWater continuing to limit annual price increases

⁷ Report of the Auditor-General No. 7 of 2014-15. Auditor-General's Report on the Financial Statements of State entities - Volume 4 Local Government Authorities, Joint Authorities and Tasmanian Water and Sewerage Corporation Pty Ltd 2013-14. Part I: Key Points, Joint Authorities, TasWater and Other Matters (February 2015), page 87.

for customers paying under the target tariff due to concerns about the impact on the economy and the potential hardship created for households. Anglicare and TasCOSS also considered that many households would struggle to pay even a 10 per cent or \$100 annual increase in prices.

Discussion

The Regulator considers that the level of the preferred price constraint (ie the greater of \$100 or 10 per cent) provides an appropriate balance between managing the impact on customers, addressing regulatory compliance issues, improving TasWater's financial sustainability and achieving tariff reform.

Adopting a lower price constraint scenario would be unlikely to achieve the desired price reform or improve TasWater's sustainability. Adopting a lower price cap would also delay the achievement of equitable pricing.

Whilst adopting a higher price constraint scenario would address these issues, the higher annual price increases may represent a significant price shock to some customers.

Decision

No change to the Draft Report.

6.14 Headworks Charges

In its draft Report, the Economic Regulator proposed requiring TasWater to adopt a 'within serviced land' approach to imposing headworks charges comprising:

- a low ('nominal') flat rate headworks charge for all developments within serviced land;
- a higher ('standardised') flat rate charge to all developments that represent extensions to serviced land; and
- for stand-alone projects, a charge calculated according to the net present value of the infrastructure TasWater is required to provide and the future revenue it expects to receive from that infrastructure.

The Economic Regulator sought comment on its proposed approach to imposing headworks charges as well as the appropriate level of the charge for each of the nominal and standardised charges.

The Tasmanian Government's submission suggested that headworks charges should not be imposed in locations where existing or planned capacity is utilised.

TasWater's submission suggested that headworks charges not be applied during the second regulatory period.

A number of other submitters supported the continuation of the current waiver of headworks. However, as noted in section 3.7 of this document, the continuation of

the waiver is outside the Economic Regulator's control ie it is a matter for Government policy.

Discussion

TasWater outlined in its submission that, in the longer term, it remains committed to the headworks charging approach outlined in its proposed price and service plan. This approach involves headworks charges being imposed only in locations where there is no existing capacity and development is not consistent with TasWater's immediate infrastructure growth plans (as is to be outlined in its Strategic Asset Management Plan).

However, TasWater acknowledges that the current timing of the development of its Strategic Asset Management Plan⁸ creates a degree of uncertainty with its preferred approach at this time. For this reason, TasWater's submission recommended that headworks charges not be applied during the second regulatory period and that a "user (ie developer) pays" approach be applied to developments outside serviced land (ie the user pays approach would apply) in relation to works internal (infrastructure which is internal within a subdivision) and works external (where a development requires stand-alone assets).

As noted in the draft Report, the Economic Regulator accepts that a sensible headworks charging approach should encourage the use of existing capacity where it exists before requiring TasWater to invest in network augmentation. With respect to developments within serviced land, TasWater has not provided any indication of the extent or location of unutilised capacity that exists within its network. For the Economic Regulator to determine whether the level of any headworks (flat) charge within serviced land would be consistent with cost-reflective pricing and other legislative Pricing Principles, the Economic Regulator would have to have some understanding of the extent of unutilised capacity together with confidence that there was a transparent, robust and impartial process in place to establish capacity.

However, the Economic Regulator also accepts that developments within serviced land benefit existing customers when new customers connect because fixed costs are spread over a larger customer base.

Despite the lack of information relating to unutilised capacity, the Economic Regulator has therefore decided to accept TasWater's proposal for the nominal headworks charge for developments within serviced land to be set at zero, ie no headworks charge for developments within serviced land.

In relation to developments that represent extensions to serviced land, the Economic Regulator accepts that many of these developments are likely to also utilise existing capacity. The Economic Regulator has therefore decided that all

⁸ TasWater's Asset Management Plan is to be submitted to the Economic Regulator by 30 June 2015 and is to be audited by 31 August 2015.

developments that utilise existing capacity will not be subject to a headworks charge.

However, the Economic Regulator considers that for a headworks charging approach to encourage the use of existing capacity, an obvious corollary is that some locational price signals must be applied and be linked to capacity. Therefore, for any development that represents both an extension to serviced land and requires TasWater to undertake works (not covered by 'works external' arrangements), the Economic Regulator considers that TasWater should impose a headworks charge on the component of that development that can't be satisfied by existing capacity. The Economic Regulator considers that the current Net Present Value (NPV) methodology, as approved by the Economic Regulator in 2012 for the first regulatory period, is an appropriate methodology to apply in making this calculation ie the headworks charge is calculated as the difference between the value of the assets required to service the headworks zone and the amount to be funded by periodic charges over a specified time period (as calculated by the present value of the periodic charges).

The Economic Regulator also considers it appropriate that TasWater continues to adopt a NPV methodology for determining headworks charges for standalone projects.

For developments relating to extensions to serviced land or to standalone projects, the Economic Regulator acknowledges that there may be relatively few occasions where the application of a headworks charge is necessary as the developer charges associated with works internal and works external will, in some instances, incorporate all necessary works.

In relation to future regulatory periods and the preferred longer term approach outlined in TasWater's submission (ie TasWater's initial proposed approach to headworks charges for the second regulatory period), TasWater will need to seek the Economic Regulator's approval when it submits its associated proposed price and service plan as a part of subsequent price determination investigations undertaken by the Economic Regulator.

The Economic Regulator will work with TasWater to ensure it drafts a compliant developer charges policy. TasWater's final Price and Service Plan will be required to include the final version of that policy.

Decision

Amend section 6.2.5 of the Draft Report to approve TasWater not imposing any headworks charge for developments within serviced land or developments occurring outside of serviced land but utilising existing capacity.

Further amend section 6.2.5 of the Draft Report to approve TasWater imposing a headworks charge, using the NPV methodology, on the component of a development that can't be satisfied by existing capacity for developments occurring outside serviced land.

7 MISCELLANEOUS

7.1 Growth Rates

TasWater supported the adoption of the Economic Regulator's annual growth rate assumption of 0.3 per cent instead of 0.5 per cent originally proposed by TasWater in its PSP. It is noted that the Economic Regulator's Draft Report relied on more up to date economic data released by the Department of Treasury and Finance in December 2014 whereas TasWater had relied on information available at the time of preparing its proposed price and service eplan ie the growth rates had been revised during the intervening period.

Decision

No change to Draft Report. TasWater's final price and service plan is required to reflect revenue forecasts for the second regulatory period based on a 0.3 per cent growth rate.

7.2 Transparency

The Tasmanian Government believes that there are areas in the Draft Determination which lack transparency and may present issues for current and potential customers of TasWater. Without consistent and publicly available criteria in relation to a range of policies, customers cannot be confident that they are subject to a single policy applied across the state or that the policy is being correctly applied in their particular case.

At a meeting with ministerial and departmental advisers, officials also raised the possibility of requiring TasWater to provide more detailed information to customers. For example, TasWater could provide an itemised quote to customers in relation to the estimated cost of connecting a property to the network.

Discussion

The Economic Regulator has proposed requiring TasWater to make publicly available a significant amount of additional information in its final price and service plan.

The Economic Regulator has worked closely with TasWater since the release of the Draft Report to ensure that TasWater has policies that apply statewide and are consistent and comply with legislative and statutory requirements.

The Customer Service Regulations and the Code relate only to billing and accounts ie the requirements set out in the Regulations and in the Code do not extend to operational matters such as requiring itemised quotations to be provided for connections. The Regulator has not seen any evidence of this being a widespread or systemic issue or concern of customers. If the Government considers this a

sufficiently important issue, it retains the power to regulate to require TasWater to make these additional disclosures.

Decision

No change to the Draft Report.

7.3 Additional changes

In addition to the changes discussed in this document, a number of minor drafting changes have been made to the Draft Report to include omitted definitions, correct typographical and grammatical errors and to improve the Draft Report's clarity.

The Economic Regulator has also reviewed the formulae outlined in Schedule 1 of the draft Price Determination in Appendix 1 of the Draft Report and, in consultation with TasWater, made a number of changes to ensure that the formulae accurately reflect the Economic Regulator's approved price reform approach.