

Water and Sewerage Industry Act 2008

Inquiry to Inform the Development of an Interim Price Order for the Tasmanian Water and Sewerage Sector

Terms of Reference

Objectives

The objective of the Interim Price Order is to transition the water and sewerage industry towards full cost recovery (including commercial return on assets) and consistent pricing arrangements that will be likely to apply from 1 July 2012 under the first price determinations.

The Interim Price Order will cover the three-year transition period commencing 1 July 2009. The Order will have an in-built review mechanism (likely to be completed twelve and twenty-four months after the Order is gazetted) to ensure that the impact of any new data or revised regulatory parameters are considered, as well as potentially examining a transition to a consistent pricing methodology. A key objective is to move to two-part pricing as soon as practical.

These Terms of Reference represent the first phase of the development of the Interim Price Order and they are focussed on achieving an initial municipality-based revenue requirement path over the three year transitional period.

Separate Terms of Reference will subsequently be issued for the review of the Interim Price Order.

Interim Price Order

The *Water and Sewerage Industry Act 2008*, which reforms the regulatory arrangements in the water and sewerage sector in the State, was proclaimed on 9 July 2008. Part 6 of the Act, Transition to New Regulatory Arrangements, provides powers for various interim provisions to assist the transition to occur effectively. In particular, Section 88 provides the power for the Treasurer to issue an Interim Price Order in respect of pricing arrangements for water and sewerage services during the transition period.

In light of findings regarding the sustainability of past pricing in the sector (ie low returns and a resultant significant forward capital investment task), an Interim Price Order will aim to transition prices such that significant price shocks to consumers are avoided when regulated price determinations commence after 2011-12. Any Order should also provide the new Regional Corporations with sufficient funding to start to address priority capital issues through the three year regulatory transition.

Current data limitations and questions over the robustness of available information for the sector at this time will constrain the level of sophistication that can be applied to the pricing approach adopted through the transition period. However, any approach adopted should aim to be easily understandable to water and sewerage customers, practically implementable by the new Corporations and, to the extent possible, assist in moving pricing arrangements towards those envisaged under the new regulatory framework.

Minister to Require Regulator to Conduct an Inquiry

Section 7(2) of the *Water and Sewerage Industry Act 2008* provides the power for the Minister for Primary Industries and Water to direct the Economic Regulator to conduct an inquiry into any matter relating to the regulation of the industry that the Minister considers necessary.

As such, the following Terms of Reference represent the Minister's direction to the Regulator to conduct an inquiry into the options available for interim pricing, and provides contextual constraints to the scope of the inquiry.

The Regulator is required to formally report back to the Minister and the Treasurer by 31 October 2008. Upon receipt of these findings, the Treasurer will develop a draft Interim Price Order. This draft Order, along with the Regulator's Report will then be released for public consultation. This process satisfies the requirement for the Treasurer to obtain advice from the Economic Regulator on the matters contained in any Interim Price Order (s88(2) of the *Water and Sewerage Industry Act 2008*).

A finalised Interim Price Order is anticipated by the end of February 2009.

Inquiry Parameters

There are a number of assumptions and constraints which the Economic Regulator is to take into consideration when conducting the Interim Price Order inquiry. These are detailed below.

- (i) The Inquiry is to consider interim pricing arrangements for reticulated urban water and wastewater services only. Pricing for tradewaste and recycled water are outside the scope of the inquiry.
- (ii) Recommended interim pricing arrangements should be designed to avoid large one-off price shocks when full price regulation and determination commences after 2011-12.
- (iii) A likely future price regulation approach that embraces full cost recovery and use of the building block approach to determine maximum revenue requirements is to be assumed (eg ARMCANZ Guidelines for Water Pricing).

- (iv) The Regulator will be required to determine the initial regulatory asset value, with all municipal valuations to be brought to a common reference year of 30 June 2008.
- (v) Interim pricing arrangements must aim to provide the soon to be established Regional Corporations with sufficient revenue to start addressing infrastructure inadequacies through transition.
- (vi) Any approach should consider the underlying intent of s35 of the Water and Sewerage Corporations Act 2008 under which it is contemplated that returns at least at the level of sustainable pre-transfer water and sewerage returns be maintained for owner councils over the first 5 years of operation of the Regional Corporations.
- (vii) The functional capability of the pricing and billing systems available to the Regional Corporations which can implement the terms of any Order must be considered. (For at least the first year of operations, it is expected the Regional Corporations will raise revenue by charging consistently with current council pricing structures)
- (viii) There will be a formal Community Service Obligation arrangement for the sector. The Government has indicated in the Second Reading Speech for the *Water and Sewerage Industry Act 2008* that, similar to electricity sector, the CSO arrangements will be funded by the owners of the corporations and it is anticipated the CSO will be implemented concurrently with the Interim Price Order.
- (ix) Interim pricing arrangements should, where possible, be consistent with the pricing principles contained in the *Water and Sewerage Industry Act 2008*.
- (x) The Regulator is expected to consult with the Director of Public Health and the Director of Environmental Management regarding legislative obligations and implications for capital works and likely standards of service.
- (xi) Interim pricing arrangements should be considered in the context of an ultimate goal of transitioning towards a common State-wide pricing methodology.
- (xii) It is expected that a move to increasingly consistent headworks/developer charges arrangements will occur through transition and that these will reflect the application of a set of high level principles. As these principles are yet to be developed, the Regulator is to assume that historical capital contributions have been reflected in the initial asset base

(however developed) and is to also apply a headworks/developer charges framework which is modelled on a robust approach used in other jurisdictions.

- (xiii) There will be a move to a commercial rate of return on all assets, existing and new, during transition, with the Regulator to assume a benchmark rate of return derived consistent with accepted approaches.

Requirements

In the context of the assumptions and constraints detailed above, the requirements and aims of the Inquiry are as follows.

1. Investigate the potential change in future revenue requirements for each region in the urban water and sewerage sector over for the three year regulatory transition period commencing 1 July 2009.
2. Investigate the potential variation in future revenue requirements for differing municipalities, which may be informed by case study analysis.
3. On the basis of 1 & 2, draw conclusions regarding:
 - I. the amount of revenue required by each Regional Corporation to meet the cost of providing operational and capital programs;
 - II. the break up of the required revenue by municipal (or other) area;
 - III. changes to average prices required that will achieve the required revenue recovery; and
4. On the basis of the findings in 3, develop options for transitioning revenue requirements to full cost recovery (including a commercial rate of return on assets) when a fully price regulated framework commences.
5. Recommend a preferred option for transitioning revenue requirements over the three year regulatory transition period beginning 1 July 2009, notwithstanding the planned twelve and twenty-four month reviews of the Order.
6. With regard to the conclusions drawn in 3.I, 3.II and 3.III, provide advice on the ability to transition to commercial returns on assets and impacts on the quantum of capital investment if binding side constraints that limit the increase in prices faced by customers were to be introduced. Would these side constraints have any impact if the parameter in (xiii) was a move to commercial returns only on new and renewal assets?

7. In carrying out 1 to 5, document data limitations and availability issues and outline information collection priorities which would aid the future Interim Price Order review or price regulation more broadly.

Interim Price Order Timeline	
August 2008	Terms of Reference Issued by Minister for Primary Industries and Water
31 October 2008	Economic Regulator to provide Inquiry Report to Minister for Primary Industries and Water
End November 2008	Draft Interim Price Order and Inquiry Report to be released for consultation
End January 2009	Consultation Period Closes
End February 2009	Interim Price Order Finalised and Gazetted