

TASMANIAN GOVERNMENT SUBMISSION

LEGISLATIVE COUNCIL SELECT COMMITTEE INQUIRY ON TASWATER OPERATIONS



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Overview

The Tasmanian water and sewerage sector has been the subject of ongoing review, reform and change over the past decade. While the industry has achieved a number of improved outcomes, significant challenges remain, particularly in relation to regulatory compliance.

The Government considers that the ultimate objective of achieving regulatory compliance in this sector remains both valid and a priority. This is important to:

- protect public health through ensuring appropriate drinking water quality;
- protect the public through dam safety;
- protect the environment and public health through the appropriate treatment and disposal of household, commercial and industrial sewage; and
- ensure a financially sustainable and customer focussed essential service to support economic activity and development.

It is recognised that achieving regulatory compliance usually comes at a cost and takes time to put in place, particularly in an industry like the water and sewerage sector where assets are long-lived and can be complex from an engineering perspective. The independent Tasmanian Economic Regulator has acknowledged that the regulatory compliance challenges facing the industry have arisen due to years, if not decades, of inadequate investment prior to the implementation of the industry reform program and that it will take many years to fully address these issues.

However, as detailed in this submission, the arrangements to achieve regulatory compliance improvements in the Tasmanian water and sewerage sector in a managed and efficient manner are already in place through:

- the operation of the economic regulatory framework, integrated with the compliance improvement requirements of relevant industry regulators in areas such as public health, the environment and dam safety; and
- the Government's commitment to contribute \$200 million to TasWater in equity payments to speed up capital investment to address regulatory compliance sooner while appropriately managing the impacts upon customers.

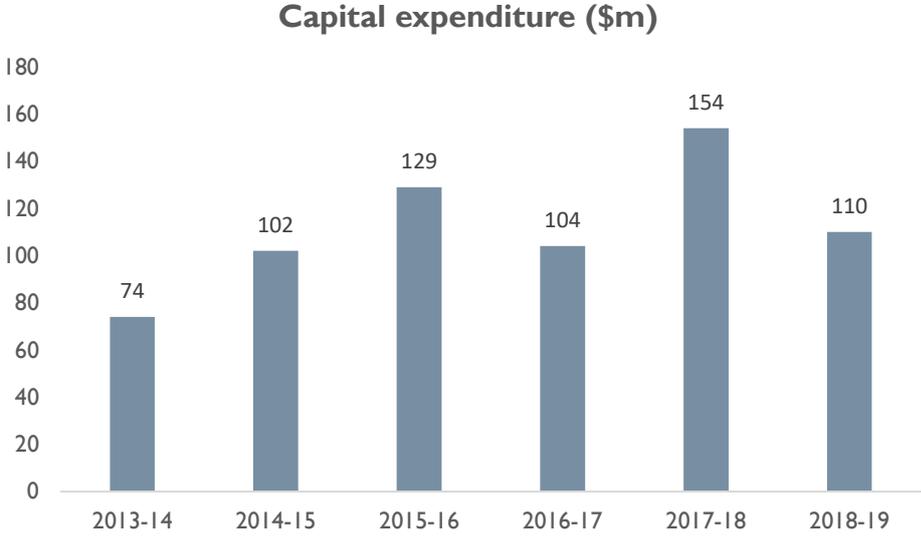
While there remains much work to do, there has been an ongoing trend of regulatory, economic and financial improvement achieved by the industry over the past decade.

The trend in TasWater's annual capital expenditure has been increasing in recent years. Planned future increases in capital expenditure, supported by the State Government, will help support economic activity in Tasmania which is particularly important given the recent effects of the COVID-19 pandemic.

While the current COVID-19 pandemic will no doubt present ongoing additional challenges and uncertainties, the Government will continue to liaise and work with TasWater to ensure the best outcomes for Tasmanians.

To assist the Select Committee in its deliberations, this submission provides some of the history and context to the current situation as well as detailing how the current regulatory

arrangements work in practice to deliver regulatory compliance improvement in a considered and efficient manner. This submission also addresses the specific regulatory issues identified in the Terms of the Reference of this Select Committee Inquiry.



Background

Reform of the Tasmanian water and sewerage industry has been an evolving process over a number of years. Before examining the current situation facing TasWater and the industry more broadly, it is important to first understand the changes to the industry that have occurred in terms of both structure and regulation over the past decade.

Water and sewerage services were historically delivered by individual local government councils and three regional bulk water authorities, which were originally owned by the State Government with ownership subsequently transferred to respective local governments.

A State Government review was undertaken of the sector in 2006. This review identified a number of issues.

In an attempt to address these concerns, the *Water and Sewerage Industry Act 2008* and the *Water and Sewerage Corporations Act 2008* were developed and passed by the Parliament.

The Act provided for the establishment of three local government owned water and sewerage corporations, supported by a common services provider (Onstream). These corporations commenced operation on 1 July 2009, taking over the water and sewerage services, staff and assets previously held by local councils.

Following implementation of the initial reforms, significant work was undertaken to examine a move towards a single state-wide water and sewerage business. A number of benefits were identified in moving to a single corporation.

Accordingly, the *Water and Sewerage Corporation Act 2012* was developed and passed by the Parliament, following a vote by Local Government Association of Tasmania members.

The amalgamation of the three regional corporations and Onstream into one state-wide corporation, TasWater, occurred on 1 July 2013. Since then, TasWater has continued to operate in accordance with the *Water and Sewerage Corporation Act 2012* as a single corporation.

While it was accepted that TasWater was improving compliance outcomes when compared to the previous structure, the Government and other stakeholders had concerns with the pace of the transition to compliance, which was limited by TasWater's financial position, and the ultimate price impact on customers.

In March 2017 the State Government announced that it would seek to take over TasWater from July 2018. The Government proposed to do so by introducing legislation later that year to enable this to occur. This move was fiercely resisted by TasWater, its shareholder members and ultimately the legislative Council. The legislation did not progress and the proposal by State Government to take over TasWater was abandoned.

In 2018 TasWater and its shareholders signed a Memorandum of Understanding with the State Government which committed to accelerate water and sewerage infrastructure investment and deliver water and sewerage services to Tasmanians at more affordable prices. On 27 September 2018, council owners voted in support of the measures in the MoU.

The measures outlined in the MoU have been implemented through legislative amendments; a Share Subscription and Implementation Agreement between TasWater and the State Government; and changes to TasWater's governance framework. The MoU also included a price freeze in 2019-20 and an annual price increase cap of 3.5 per cent from 2020-21 to 2024-25.

The Share Subscription and Implementation Agreement outlines the State Government's agreement to contribute \$200 million in equity payments over a 10 year period from 2018-19 in exchange for 10 per cent of the total shares on issue in TasWater.

The State Government's shareholding does not include the entitlement to any dividends from TasWater.

As part of the 2019-20 State Budget, the Government committed to re-profile its \$200 million TasWater equity contribution over five years from 2018-19. This funding is intended to allow TasWater to implement its accelerated infrastructure program, as well as to progress major infrastructure projects. A further \$100 million of grant funding will be provided over five years from 2023-24.

Notwithstanding the revised funding profile of the equity payments, the Government's equity in TasWater will continue to be capped at an ultimate maximum of 10 per cent and the State will not receive returns from its investment in TasWater to ensure the price outcomes agreed to in the MoU are maintained.

It is important to note that as a 2% shareholder, the State Government does not have control the operations of TasWater, nor does it have the power to intervene in the day-to-day business operations of TasWater. Rather, the State Government monitors the progress of TasWater's business outcomes.

The Crown is involved in TasWater's Corporate Planning process and receives TasWater's quarterly financial reports. Under the new governance framework, the Crown has greater access to information from TasWater more generally given the State is now a minor shareholder. The State Government also monitors TasWater's business outcomes through the Tasmanian Economic Regulator's reporting.

Since becoming a shareholder, the State Government has noted positive progress by TasWater in the key areas of drinking water quality and sewage treatment. However, ageing infrastructure continues to be a challenge for TasWater, resulting in water main breaks, water loss and sewage spills. TasWater's accelerated capital investment program, which is supported by State Government funding, is expected to lead to further compliance improvements in the future.

The State Government recognises the challenges facing TasWater are significant and will be addressed over time and not in the short term.

Regulatory framework and compliance improvement

The economic regulatory framework applying to the Tasmanian water and sewerage industry is designed to integrate with other industry regulatory arrangements in relation to public health, dam safety and environmental compliance.

The economic regulatory framework involves more than just the relevant legislation and regulations, but also encompasses the guidelines, codes and regulatory practices of the Tasmanian Economic Regulator; including the obligations it places upon TasWater and its interactions with other industry regulators.

In July 2008 the economic regulation of the water and sewerage industry was added to the Tasmanian Economic Regulator's statutory responsibilities.

The Water and Sewerage Industry Act provided a new regulatory framework to apply to the industry, including independent regulatory oversight, customer service and price regulation, and performance monitoring and reporting.

The economic regulatory framework involves the independent regulation of price and service standards in line with well accepted models for the regulation of monopoly service providers. However, in the context of the situation facing the Tasmanian water and sewerage industry, this framework also provides a mechanism to manage the transition towards the achievement of compliance with relevant regulatory requirements in a manner that balances the interests of industry regulators, customers and the financial sustainability of the industry.

The Tasmanian Economic Regulator is responsible for the regulation of water and sewerage pricing within Tasmania.

The regulated maximum prices are set using a "building block" approach, whereby the assessed efficient costs of providing water and sewerage services to customers are added together to determine TasWater's annual revenue limits. This includes capital investment and operating costs to maintain assets and achieve regulatory requirements. Prices are then set so that expected revenue does not exceed the determined limits.

The revenue limits only reflect those costs that the Economic Regulator considers prudent (justifiable and needed) and efficient (representing the least cost to consumers in the long term). Maximum prices, set within the assessed annual revenue limits, are determined by the Tasmanian Economic Regulator following a price determination investigation.

TasWater is required to prepare a proposed Price and Service Plan for each upcoming regulatory period. The Plan sets out the services TasWater intends to provide; its proposed expenditure plans and the prices it intends to charge customers.

The Tasmanian Economic Regulator then produces a draft report summarising proposed decisions, reasoning and any changes considered necessary to the proposed Price and Service Plan.

After a period of public consultation, and taking into account any submissions received as part of the consultation process, the Tasmanian Economic Regulator issues a final report and makes a final price determination, which includes the maximum prices TasWater may charge over the regulatory period.

The regulatory pricing framework is designed to prevent TasWater from earning a profit greater than that which might be earned by a business operating in a competitive industry.

The price determination investigation process also assesses minimum customer service standards such as numbers of water main breaks, response times to issues with the network and call centre performance. These minimum service standards have been updated over time, taking into account customer preferences and the cost of improved services. These minimum standards are in addition to the baseline customer service requirements stipulated in the Regulator's Customer Service Code.

TasWater is required to comply with a range of legislative and regulatory obligations. The main industry regulators with respect to the water and sewerage sector in Tasmania are:

- the Director of Public Health (drinking water quality);
- the Department of Primary Industries, Parks, Water and Environment (dam safety); and
- the Environmental Protection Authority (regulation of sewage treatment plants)¹.

Each of these industry regulators has its own set of legislation, regulations, guidelines and responsibilities.

In developing proposed Price and Service Plans, TasWater uses a risk-based approach to prioritising compliance activities. In consultation with industry regulators, this process identifies and addresses the areas of highest risk first and allows for TasWater to achieve the greatest regulatory compliance improvements in the shortest time.

Further information on the State of the Industry Reports can be found on the Tasmanian Economic Regulator's website

<https://www.economicregulator.tas.gov.au/water/performance-monitoring>.

¹ EPA regulates Level 2 sewage treatment plants as described in the Environmental Management and Pollution Control Act 1994 Schedule 2. Level 1 plants are regulated by Local Government.

Government Assistance

The Government assistance framework provides for the management of cost impacts and improved customer service. Years of underinvestment has led to a series of issues and the Government has decided to invest in TasWater to bring forward asset replacement and major strategic projects to address critical infrastructure issues while managing price impacts.

As a result of the State Government's investment in TasWater, the Corporation has committed to:

- freeze prices for regulated services for water and sewerage customers from 1 July 2019 to 30 June 2020;
- develop a future price profile for regulated water and sewerage services with annual price increases for target tariffs to be no greater than 3.5 per cent commencing from 1 July 2020 until 30 June 2025 ("Capped Period") (or apply such lower price determination to such price increases as may be made by the Tasmanian Economic Regulator during the Capped Period); and
- transition customers who are currently significantly below target tariffs to ensure that those customers reach the target tariffs within the legislated timeframe without facing significant price shocks.

It should be noted that TasWater has also implemented a range of measures in response to COVID-19.

Also due to the Government's investment in TasWater, the Corporation is required to collaborate with Councils, the Crown and regional agencies on matters of economic development and regional importance.

Under section 10.5 of the Shareholders' Letter of Expectations (SLE), TasWater, the Crown and the Owner Councils are expected to work co-operatively in order to progress major investment projects of special or environmental importance to Tasmania. This includes using all reasonable endeavors to secure Australian Government funding for such projects. Specific projects included in this obligation include (but are not limited to):

- the Launceston sewerage/stormwater project; and
- the works at Macquarie Point wastewater treatment plant necessary for the development of the Macquarie Point site.

In addition, as a part of the Launceston City Deal the Government has also entered into an agreement with the Australian Government to fund improvement catchment management works for the Tamar Estuary.

In determining appropriate levels of investment required to support economic development, the TasWater Board is expected to balance financial risks and benefits to the Corporation against the long term risks and benefits to the Tasmanian community, the Councils and the Crown.

Other Issues

COVID-19

In response to the COVID-19 pandemic, TasWater introduced a small business rebate, which was a 100 per cent rebate for eligible small businesses on regular TasWater quarterly bills issued between 1 April 2020 and 30 June 2020.

TasWater also introduced a price freeze for 12 months from 1 July 2020 and expanded its Customer Support Program. Due to uncertainty regarding the pandemic, the Government agreed to introduce legislation to extend the current regulatory period by 12 months to 30 June 2022.

The COVID-19 pandemic may impact on the ability of TasWater to deliver on its agreed corporate plan objectives and as a result at an appropriate time in the future it will be necessary for the planned capital expenditure program to be reviewed and amended.

As an immediate measure, the State Government provided Tasmanian Public Finance Corporation with the necessary approvals and comfort to allow TasWater to quickly access COVID-19 related borrowings, should this be required.

Capital Delivery Office

The Capital Delivery Office (CDO) was established on 1 July 2019 as an alliance agreement with UGL Engineering and CPB Contractors with support from WSP Australia. It was formed to enable an accelerated program of delivery for essential water and sewerage projects. The CDO is responsible for the delivery of all capital works from the planning, design, procurement and delivery phases.

Since its establishment last year, the operations and efficacy of the CDO appear to have improved. Anecdotal feedback is that the CDO is now putting many more projects out to market and that overall approval times have decreased. Government has received feedback from some stakeholders regarding the performance of the CDO. The Government has encouraged parties who have raised concerns, to deal with TasWater directly on these matters; something which TasWater has also welcomed.

While recent improvements in performance are encouraging, the State Government believes that a review of the CDOs' operations including its benefits and confirming that the CDO is providing the intended outcomes it was originally designed to deliver. The Government would be supportive of such a review at an appropriate time during the existing contract period.

It is important to reinforce the point that the State Government does not direct TasWater's capital program, and operational decisions are a matter for the company's management and board. For these reasons, the State Government does not seek to involve itself in decisions such as the establishment, ongoing operations and benefits of the CDO.

Trade waste

“Trade waste” is a waste stream generated by a business activity and the costs of managing that by-product of the business should be met by the business. It is not considered appropriate that other customers of the sewerage service provider subsidise the costs of treating trade waste.

In addressing trade waste issues for Tasmania, similar to other water and sewerage infrastructure, it is important to balance the need to manage the impacts on infrastructure from trade waste against the need to balance the financial imposts on businesses in transitioning to compliance.

In relation to trade waste, TasWater is not required to accept waste streams that vary significantly from household sewage unless it can safely do so. This may mean that a trade waste producer needs to install particular pre-treatment devices or processes, or meet the additional sewerage system costs faced by TasWater, or find an alternative means of properly disposing of the business activity waste stream.

In its 2018-19 annual report, TasWater reported that 27 per cent of the volume of trade waste it received was compliant with its receipt requirements.

TasWater has introduced measures to assist business customers to become compliant with its Trade Waste requirements. There are now a range of financial incentives, options and specialist advice to help businesses become compliant.

Reuse of water for irrigation

Successive Tasmanian Governments have maintained a policy position which is supportive of re-use of wastewater for appropriate purposes, including irrigation. This policy is set out in the State Policy on Water Quality Management 1997. Under this Policy, the beneficial re-use of wastewater by land application in an environmentally acceptable and sustainable manner should be encouraged and facilitated.

According to the Report on the state of the Tasmanian water and sewerage industry 2018-19, the total volume of treated wastewater re-used from Level 2 sewerage treatment plants (those treating 100 000 litres each day or more) was 5 700 ML. This was 11.5 per cent of treated effluent produced from Level 2 plants. The Clarence, Brighton/Bridgewater and Penna re-use schemes accounted for 66 per cent of this volume.

It is expected that further opportunities will be developed over time. It is likely that opportunities will continue to be developed in irrigated agriculture, horticulture and silviculture and in irrigation of recreational and other community green spaces.

Establishing effluent reuse schemes can attract higher capital costs when compared to existing discharges to surface waters. The cost difference may be favorable when the full cost of capital upgrades, including increased operational costs, are accounted for in a future discharge requirement.

Sewage treatment and biosolids

Sewage treatment including the discharge of treated effluent and disposal of treated waste biosolids is undertaken by TasWater in accordance with the requirements of the *Environmental Management and Pollution Control Act 1994* (EMPCA) and the *State Policy on Water Quality Management 1997*.

Government policy operating through these instruments supports TasWater's implementation of the waste management hierarchy in respect of both re-use water and biosolids disposal. The *State Policy on Water Quality Management* and the objectives of the *Resource Management Planning System* enacted through EMPCA enshrine waste reduction and re-use. These documents further require minimisation where reasonably practical of pollutant discharges to land, air or water through continuous improvement.

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