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Table of Abbreviations

AEC	Australian Economic Consultants
ARMCANZ	Agriculture and Resource Management Council of Australia and New Zealand
ANZECC	Australian and New Zealand Environment and Conservation Council
CEO	Chief Executive Officer
CN	Competitive Neutrality
COAG	Council of Australian Governments
Code	Code of Competitive Conduct
CPA	Competition Policy Agreements
CSO	Community Service Obligation
DCILGP	Department of Communication, Information, Local Government and Planning
DFYCC	Department of Families, Youth and Community Care
DNR	Department of Natural Resources
EA	Environmental Assessment
EPA	Environmental Protection Agency (Commonwealth)
EBIT	Earnings before Interest and Tax
FCP	Full Cost Pricing
GOC	Government Owned Corporation
GPOC	Government Prices oversight Commission
GTE	Government Trading Enterprise
IAS	Impact Assessment Study
IASS	Impact Assessment Scoping Study
kL	Kilolitre (1000 L)
LG Act	Local Government Act 1993
LGFS	Local Government Finance Standard 1994

LRMC	Long Run Marginal Cost
MDIA	Mareeba-Dimbulah Irrigation Area
ML	Megalitre (1000 kL)
NCC	National Competition Council
NCP	National Competition Policy
OMA	Operating, Maintenance and Administration expenses
PAWA	Power and Water Authority
PVWB	Pioneer Valley Water Board
QCA	Queensland Competition Authority
QCA Act	Queensland Competition Authority Act 1997
RID	Regional Infrastructure Development division, DNR
RMG	Resource Management Group, DNR
RoR	Rate of Return
RWSC	Rivers and Water Supply Commission
SAIIR	South Australian Independent Industry Regulator
SCARM	Standing Committee on Agriculture and Resource Management
SIIP	Sugar Industry Infrastructure Package
SWP	State Water Projects
TER	Tax Equivalent Regime
WACC	Weighted Average Cost of Capital
WAMP	Water Allocation and Management Plan
WMP	Water Management Plan
WSP	Water Service Provider

SUPPLEMENTARY ASSESSMENT: DECEMBER 1999

Background to supplementary assessments

The Council's *Second Tranche Assessment of Governments' Progress with implementing National Competition Policy and Related Reforms*¹ (the second tranche assessment report) considered States' and Territories' progress against their agreed second tranche water reform commitments. While the Council's assessment noted that significant overall progress had been made, it also identified a number of instances where second tranche commitments were not met. However, given that jurisdictions had demonstrated a genuine commitment to achieving appropriate reform within a reasonable period of time, the Council agreed to consider subsequent progress on each issue in a supplementary assessment in December 1999 and/or June 2000.

This supplementary assessment primarily considers outstanding water reform issues in Queensland, South Australia, Tasmania and the Northern Territory. Outstanding electricity and gas reform issues in South Australia are also canvassed.

The Council's previous consideration of progress against water reform commitments is contained in Volume 2 of the second tranche assessment report, while the previous assessment of progress against electricity and gas reform commitments is contained at chapters B7 and B8 of Volume 1.

As the supplementary assessment is concerned with progress against outstanding water reform commitments the same assessment framework as was used in conducting the second tranche assessment has been adopted. The framework is contained as an appendix to this report.

Since the Council provided its second tranche assessment report and recommendations to the Commonwealth Treasurer, governments have approved the Agriculture and Resource Management Council of Australia and New Zealand (ARMCANZ) Pricing Guidelines. Governments have also approved the recommendations of the Tripartite meeting in January 1999, which clarified elements of the strategic framework relating to institutional arrangements, pricing and groundwater.

Supplementary assessment process

The Council's supplementary assessment process has included reviewing information provided and conducting bilateral meetings between the Council secretariat and Government officials. The Council has continued its *no surprises* approach to assessment through:

- identifying key information relevant to the supplementary assessments;

¹ NCC 1999

- discussing concerns with jurisdictions as soon as these have become evident; and
- providing jurisdictions with a copy of the draft assessment for further consultation.

Because of its very limited resources, the Council's assessment process is heavily reliant on the information provided by the States and Territories. It relies on jurisdictions to provide all relevant information so that an accurate assessment and recommendation can be made. The Council notes that this arrangement is only effective where the Council has confidence that all pertinent information is being provided. While the Council is provided with information by relevant stakeholders, and it is invaluable to the assessments, it does not provide a complete picture and the Council therefore remains heavily reliant on information provided by Governments.

The Council's ability to assess reforms is confined by the nature of the assessment process with which it is charged. The *Agreement to Implement the National Competition Policy and Related Reforms* provides that:

Prior to 1 July 1997, 1 July 1999 and 1 July 2001 the National Competition Council will assess whether the conditions for payments to the States to commence on those dates have been met.

This means that, other than matters specifically identified in the second tranche report as being subject to supplementary assessments, the Council is unable to assess ongoing developments that occur after the second tranche assessment until 1 July 2001. So for example, where a new rural scheme commences between 1999 and 2001, or where other schemes come to the Council's attention that were not specifically considered in the second tranche assessment, the Council is unable to assess such schemes until the third tranche assessment. This is so even where the Council is assessing compliance with other similar reform commitments in the State or Territory. That is not to say that the Council does not raise matters with jurisdictions, but only that those matters cannot be assessed by the Council until the third tranche.

An aspect of the Council's assessment role that has been misunderstood by some people is the effect of a recommendation to suspend or reduce National Competition Policy (NCP) payments. NCP payments are an economic dividend paid by the Commonwealth to each State and Territory in return for their investment in NCP reform. The Council's role is to assess performance against agreed NCP reform commitments and make recommendations to the Treasurer regarding payments. The Treasurer either accepts or rejects the Council's recommendations, and determines the amount of NCP payments to be paid by the Commonwealth to the State or Territory. The payments are not provided for specific projects, and indeed may be spent by jurisdictions in any manner they see fit.

Supplementary assessment recommendations

Table 1 provides an overview of the Council's recommendations. Table 1 should be read in conjunction with Tables A1 and A2 contained in the overview of the second

tranche assessment report which provides further detail of supplementary assessments to be undertaken by the Council in the year 2000.

Detailed information as to each recommendation is included in the relevant assessments. Outstanding issues, including where the relevant government and the Council have agreed to a course of action to progress the issue, will be the subject of a further consideration before July 2000.

Table 1: Supplementary second tranche assessment; December 1999

Jurisdiction	Supplementary assessment issue	Recommendation on Competition Payments
Queensland	<p>Cost and pricing reforms of urban (metropolitan and rural) water and wastewater providers.</p> <p>Implementation of the recommendations of independent reviews on the introduction of two part tariffs (consumption based pricing) by local government.</p> <p>Demonstration of robust independent appraisals being conducted to determine economic viability and ecological sustainability prior to investment in rural schemes and/or implementation of the recommendations of such appraisals.</p> <p>Separation of water service providers from regulation, standard setting and resource management functions.</p> <p>Devolution of irrigation management.</p>	<p>Supplementary assessment of progress before July 2000.</p> <p>Supplementary assessment of progress before July 2000.</p> <p>Suspension of 25 per cent of second tranche 1999-2000 competition payments be lifted. Supplementary assessment of progress before July 2000.</p> <p>Supplementary assessment of progress before July 2000.</p> <p>Supplementary assessment of progress before July 2000.</p>
South Australia	<p>Progress with commercial water pricing.</p> <p>Progress with implementation of electricity reforms.</p> <p>Government's response to the recommendations of the <i>Cooper Basin (Ratification) Act 1975</i> review.</p>	<p>Supplementary assessment of progress before July 2000.</p> <p>Second tranche commitments met.</p> <p>Supplementary assessment of progress before July 2000.</p>
Tasmania	<p>Progress with water pricing reform.</p> <p>Progress with devolution of irrigation management.</p>	<p>Supplementary assessment of progress before July 2000.</p> <p>Review progress as part of third tranche assessment.</p>
Northern Territory	<p>Urban cost recovery, rates of return and cross-subsidies.</p> <p>Bulk water pricing.</p>	<p>Second tranche commitments met.</p> <p>Supplementary assessment of progress before July 2000.</p>

Jurisdiction	Supplementary assessment issue	Recommendation on Competition Payments
Northern Territory (cont)	<p>Separation of service provision from regulatory and standard setting functions.</p> <p>Legislative framework for water allocation and trade.</p> <p>Program for action on priority resources.</p> <p>Process for ensuring the economic viability of new investment.</p>	<p>Supplementary assessment of progress before July 2000.</p> <p>Supplementary assessment of progress before July 2000.</p> <p>Second tranche commitments met.</p> <p>Second tranche commitments met.</p>

Further supplementary assessments

The Council will undertake further supplementary assessments and make recommendations to the Treasurer as to further competition payments in the coming year. The next supplementary assessment report will be forwarded prior to July 2000.

WATER REFORM: QUEENSLAND

EXECUTIVE SUMMARY

This is a supplementary assessment of Queensland's performance against the strategic framework for water reform. The supplementary assessment canvasses those matters outlined in the Council's second tranche assessment (NCC 1999) that would BE the subject of further assessment in December 1999.

FURTHER PROGRESS ON REFORMS

The Council has reviewed significant further information concerning the progress of water reform. While this demonstrated the ongoing progress of Queensland in addressing reform commitments, the Council remains of the view that many reform commitments have not been met. In particular, the Council is of the view that the following second tranche commitments have not been met:

- For urban cost reform and pricing, achievement of full cost recovery, two-part tariffs where cost effective, elimination or publication of cross-subsidies and achievement of a positive real rate of return on assets.
- Institutional separation of the roles of water service provision and water resource management, standard setting and regulatory enforcement.

The Council has been provided with further information in respect of rural schemes identified in the second tranche report. On the basis of this information and forward commitments to further develop guidelines for analysis of economic viability and ecological sustainability of new rural schemes, the Council is satisfied that schemes have proceeded in a manner consistent with reform commitments, have not proceeded or should not result in a reduction in competition payments.

SUPPLEMENTARY ASSESSMENT

The Council recommends that the suspension of 25 per cent of Queensland competition payments for 1999-2000 be lifted.

The Council also recommends that particular matters be the subject of a supplementary assessment before 30 June 2000. The matters to be considered are outlined in detail in the assessment. It is recommended that this assessment include consideration of cost reform and pricing and institutional reform commitments. It includes proposed guidelines to be developed in relation to the assessment of economic viability and ecological sustainability of rural schemes.

The Council's recommendations are consistent with the four approaches to deal with outstanding issues outlined in the second tranche assessment report. In particular, while the Council is not satisfied that important second tranche commitments have been met, Queensland and the Council have agreed on a comprehensive course of action to resolve outstanding matters.

Many of the reform commitments are being implemented well outside timeframes initially envisaged by governments when they agreed to the COAG water reforms almost six years ago. While the Council's recommendations focus on the achievement of reform as opposed to strict adherence to agreed timetables, NCP payments are the dividend for achievement of reform.

Should the Council be of the view that agreed commitments have not been achieved by Queensland, it would be likely to recommend to the Treasurer that there be a reduction in NCP payments for the year 2000-2001.

REFORM COMMITMENT: COST REFORM AND PRICING

Full cost recovery, Major Urbans and Non-Metropolitan Urbans

Outstanding issue, June 1999

The Council was not in a position to arrive at any conclusion as regards cost recovery across the Queensland urban water industry, due to the inability of Queensland to provide information. The information provided focussed on the *big 17* local governments. There was no substantial information concerning the valuation of assets. In respect of most service providers there was no information available at all.

Queensland offered to provide further information following the collection and analysis of this data by the Queensland Competition Authority.

Developments since June 1999

Information provided by Queensland included the *Local Government National Competition Policy Financial Incentive Payments Scheme. Recommendations for Payments for Reforms effected during the year ended 31 July 1999* report (QCA 1999). Queensland also provided further information in correspondence² and a bilateral meeting with Queensland representatives in November 1999.

Information provided concerning cost recovery across those local governments with more than 5000 connections is set out at Attachments 1 (the *big 17*) and 2.

The QCA report

The role of the QCA

The QCA examines and reports annually to the Premier and Treasurer over five years (1998-2002) on the implementation of competition policy reforms by local government. It recommends payments to Councils under the Local Government Financial Incentive Payments Scheme (the scheme). The scheme allocates up to \$150m³ over five years, and the QCA makes recommendations in relation to the \$141.5m *Implementation Pool*. Ten per cent or \$14.1m is allocated to the implementation of water reform including tariff reform where cost effective and the identification and disclosure of subsidies, cross-subsidies and community service obligation (CSO) payments. In addition, the implementation of competitive neutrality (CN) reforms, incorporating assessment of the application of commercialisation and full cost pricing (including to water and sewerage businesses) is allocated 85% or \$120.3m.

The role of the QCA is to determine the extent to which local governments have complied with reform requirements and to recommend payment up to the capped amount. The initial focus for water reform is on the preparation of a two-part tariff

² Received 29 November 1999 and 9 December 1999

³ \$1994-1995

report or similar assessment (20 per cent), then on implementation of appropriate charges (70 per cent) and finally ongoing compliance (ten per cent). Assessment of CN reforms is also three phased: structural change relating to the commitment to apply reforms and the creation of separate business entities (20 per cent); reform implementation relating to clear objectives, managerial autonomy, performance standards and competitive neutrality (70 per cent); and ongoing performance (ten per cent).

CN reforms

For local government businesses that are significant business activities (Type 1 and Type 2 activities⁴) local governments must choose between corporatisation, commercialisation or full cost pricing:

- Corporatisation involves creation of a separate legal business activity. No activities have been corporatised.⁵
- Commercialisation requires the establishment of a separate business unit with the key objectives of being commercially successful as well as being efficient and effective in the provision of goods and services. S 576 of the (Q) *Local Government Act 1993* (the LG Act) identifies key principles of commercialisation as clarity of objectives, management autonomy and authority, accountability for performance and CN.

CN in part involves the application of full cost pricing which in turn requires the incorporation of estimates of operational and resource costs, administrative and overhead costs, depreciation on assets, tax equivalents, debt guarantee fees and return on capital. For depreciation, the QCA sought evidence of assets being valued according to the deprival value approach, the depreciation of those assets according to a commercially appropriate method and the incorporation of depreciation in pricing decisions.

- Full cost pricing (FCP) as a reform option requires, in respect of CSOs, that local governments are only required to treat as revenue an amount equivalent to the cost of carrying out the CSO less any revenue raised.

For other businesses, the application of the *Code of Competitive Conduct* (the Code)⁶ is at the discretion of local government. The elements of the Code relevantly include full cost pricing and the treatment of CSOs. The Code notes that the application of

⁴ Relevantly, a Type 1 business activity have a current expenditure of at least \$25m per annum at 30 June 1993 (adjusted for inflation) for water and sewerage. A Type 2 business activity has current expenditure of at least \$7.5m per annum for water and sewerage. A Type 3 activity has a current expenditure of at least \$200 000 and is trading in goods and services in competition with the private sector. A Non-Type 3 activity is a business activity has a current expenditure of at least \$200 000 and is not in competition with the private sector. There are 73 *Non Type 3* local government water and sewerage business activities that have been nominated for COAG water reforms.

⁵ Queensland has noted that local governments continue to be deterred from implementing corporatisation due to uncertainty over the tax status of local government owned corporations. Queensland has advised that both State and local government have requested that the issue be clarified by the Commonwealth Government.

⁶ Chapter 9 of the LG Act and Part 10 of the *Local Government Finance Standard 1994*

full cost pricing requires local government to ensure, in deciding charges, that the projected total revenue from the activity is enough to cover the projected total costs for the financial year or a longer period (not greater than five years)⁷. Total costs include operational, administrative, overhead, resource, depreciation⁸, TER, debt guarantee and return on capital elements. CSOs (an amount equivalent to the cost of carrying out the activity less any revenue raised) must be treated as revenue.

The QCA notes that significant business activities that have not applied full cost pricing are required to introduce at least full cost recovery (no requirement of TERs and debt guarantees in charges for goods and services, RoR a positive rate decided by the entity) and smaller business activities are required to introduce generally equivalent reforms.

COAG water reforms

The QCA notes that for significant water and sewerage businesses, Councils are required to: prepare a report on the cost effectiveness of two-part tariffs and resolve whether to apply a two-part tariff⁹; apply consumption based water charges; apply full cost pricing/recovery; and disclose cross-subsidies, subsidies and CSOs. The QCA notes that it is presently developing the regulatory pricing principles it envisages applying to the urban water sector. Whether or not a two-part tariff is applied, consumption is to form the basis of charges. Where charges are based on meter readings the *Local Government Finance Standard 1994* (the Standard) provides for charging on fixed amount (which can be zero) and consumed units. Where there is no metering, charges must be based on the average estimated consumption of all consumers in a group.

QCA findings

In its second report, the QCA noted that the COAG water reforms had progressed faster than competitive neutrality reforms and that 79 local governments had commenced the reforms, compared to 38 local governments a year ago, although many are at an early stage of implementation.

Twelve of the 18 local governments with Significant Business Activities¹⁰ had made 'impressive progress' in implementing reforms, 'resulting in recommendations ranging from 50 per cent to 70 per cent of their respective caps'. Matters remaining are noted to include completion of full cost pricing, correct identification and quantification of CSOs, disclosure of cross-subsidies and demonstration of ongoing performance¹¹.

⁷ *Local Government Finance Standard*, s 85.

⁸ Based on deprival value of the asset allocated over its useful life or an amount decided by the local government to be appropriate in the circumstances, LG Act, s 90.

⁹ If a council rejects a recommendation to apply a two-part tariff, a further report is required within three years after the end of the financial year in which the report was presented.

¹⁰ The *big 17* and Bundaberg City Council. The QCA advised that full cost pricing assessments for significant businesses were undertaken in the context of the CN assessments.

¹¹ Under the Local Government Act 1993, some of these reforms are not due until 30 June 2000.

The QCA notes that a Local Government Technical Issues Working Group (the working group) and its own work in relation to water pricing principles are addressing common themes in full cost pricing including the appropriate RoR, depreciation charges and allocation of overheads.

For other local governments, 18 received funding recommendations for either full cost pricing or full cost recovery reforms. For Councils seeking funds for full cost recovery reforms *'evidence was not generally provided that revenues were sufficient to cover depreciation on deprival value and the application of a rate of return. The requirement that councils value their assets on the basis of deprival value by 30 June 1999 will mean that recommendations for this reform may accelerate in the next assessment period'*.

The QCA noted that the requirement for it to report by 30 November each year limited the ability of local governments to provide timely data, as they are required to publish audited accounts by the same date. Access to those reports will become increasingly important. The QCA therefore recommended that its reporting deadline be altered to 28 February of each year.

Further information provided by Queensland

Information provided by Queensland indicated that, of the *big 17* local governments, Caboolture, Cairns, Noosa, Pine Rivers, Toowoomba and Thuringowa have implemented full cost pricing reforms while the remaining have implemented commercialisation. It was noted that all of the *big 17* are at least covering minimum pricing requirements and most earning a real rate of return. For the next eleven (including Bundaberg), the information was said to demonstrate that local governments *are recovering operating costs, depreciation and finance costs*. Of the 108 non-*big 17* local governments, the following summary of cost performance was provided:

Table 1: Summary of cost performance by 108 local governments

Level of cost recovery	Number of Councils	Number of water connections	Percentage of water connections
Partial cost recovery ¹²	70	187 805	83.57
Operating loss	15	21 387	9.52
No information	23	15 529	6.91

Queensland have advised that assets for the *big 17* local governments are valued on a deprival basis (and at various stages of optimisation) and the assessments are signed off by the Auditor General. The Council was also advised that the financial figures for five of the *big 17* local governments are not separately reported and therefore could not be provided.

¹² Revenue from water and sewerage operations exceeds operating expenditure from water and sewerage activities. Total costs may include direct operating costs, depreciation and finance costs. Surpluses from water and sewerage operations may be distributed between provision for capital maintenance and a distribution to the local government's consolidated fund.

Queensland has also provided the Council information, including draft legislation, that will provide for oversight by the QCA of pricing decisions of some water service providers. Further detail regarding this is contained in the *Institutional Separation* section of this supplementary assessment.

In addition, Queensland provided the Council with the *Competitive Neutrality Resource Kit Guidelines*¹³. It was noted that the Guidelines are intended to provide assistance to local governments in applying full cost pricing and are also recommended for those local governments which voluntarily choose to adopt the Code for water and sewerage activities.

Volume 2 of the Guidelines, *Application of Full Cost Pricing*, notes the two stage approach to FCP; corporate overhead costing and activity based costing. Activity based costing required the calculation of the full cost of delivering goods and services associated with a particular business activity, and is noted to include the following elements: operating costs; non-current assets; taxes and tax equivalents; debt financing costs including a debt guarantee; and other CN adjustments. Income tax and return on capital are to be included following the establishment of the cost benchmark. CSOs need to be identified and costed.

Discussion

The Council notes the gradual progress of Queensland in implementing full cost recovery. As noted by the QCA, this progress is heavily concentrated in the larger local governments which are required, as opposed to encouraged, to implement reform.

The Council has not undertaken a detailed assessment of every local government's level of cost recovery, but has instead reviewed the information provided and had particular regard to the assessments of the QCA.

Big 17

The information provided to the Council demonstrates that all of the *big 17* local governments are recovering operating, maintenance, administration and depreciation charges. The Council notes the signing-off of asset valuation by the Auditor General should ensure the rigour of these valuations. In addition, all but one are recovering tax equivalent payments, and the Council was advised that Toowoomba is phasing in full cost pricing over five years. Further, the majority of these local governments are recovering interest costs and making dividend payments to their local governments. All are returning a positive RoR on assets.

The Council notes that it has not been provided with information concerning the recovery of externalities, an element of pricing included in the bottom of the pricing band.

The QCA detailed assessments demonstrate the progress of most of the *big 17* local governments. They also indicate that, in general, those local governments that have

¹³ Local Government Association of Queensland 1997

not undertaken two-part tariff reform are generally the local governments that the QCA recommends receive the lowest percentage of their capped payments. The question of two-part tariff reform is canvassed in the following section.

For those local governments where sewerage and water service provision is not separately accounted for, assessment of progress is less certain. In this respect, the Council notes the advice of Queensland that reform commitments do not require that water and sewerage activities be reported on separately, and that local governments in Queensland have the option of reporting on both activities as a consolidated enterprise. The Council also notes that each of the businesses is commercialised and reports publicly as a commercialised business unit. In addition, Queensland has reported that all five are earning a positive rate of return on written down replacement costs.

However, the Council's view is that reporting on these activities as a consolidated business reflects on the transparency of arrangements, efficient pricing and the ability of customers to scrutinise them. It also impacts on this assessment in that the Council is unable to conclude whether each of the water and sewerage services is achieving reform commitments with respect to full cost pricing; the Council will require evidence that these businesses are recovering costs independently.

Greater than 5000 connections (other than the big 17)

Of the next eleven local governments (that is, those with more than 5000 connections), the information provided to the Council is less detailed. Nevertheless, the Council can conclude, on the basis of the information, that all but one of the water and sewerage businesses are recovering operating costs, finance costs and depreciation costs and recording operating profits. The extent of recovery of tax equivalent payments is unclear.

A review of the QCA report in respect of these 11 local governments indicates that, except for one¹⁴, all received a recommendation of 20 per cent of cap or less for implementation of water reforms, and seven of the 11 had not resolved to implement CN reforms, presumably including full cost pricing reforms. Given these recommendations, it is clear that almost all of these local governments are well short of reform commitments.

Other local governments

The information provided in respect of local governments with less than 5000 connections indicates that most are achieving *partial* cost recovery for their water and sewerage businesses. This means that total revenue exceeds operating expenditure, although what is included in the operating expenditure is unclear. The Council is unable to conclude that these local governments are recovering above the bottom of the band; this conclusion is consistent with the recommendations of the QCA.

The QCA assessments suggest that some local governments have progressed substantially in implementing water reforms. Some (that is, Calliope, Gatton,

¹⁴ Warwick

Hinchinbrook, Kingaroy and Stanthorpe) have a two-part tariff in place, and more relevantly a number (that is, Burnett, Dalby and Peak Downs) have begun to implement the Code. However, by far the majority have made little progress on either CN or water reform generally. The Council can only conclude that there has been limited implementation of the full cost pricing/recovery guidelines.

Other matters

The Council notes the following matters relevant to its assessment:

- in 1994, Governments agreed that cost reform and pricing obligations for urban water and wastewater service providers should be implemented by 1998. The further information provided by Queensland, although showing progress in implementing reforms, also indicates some significant delays, particularly where reform is being encouraged as opposed to required;
- Queensland has in place a process to support, monitor and encourage reforms across a large number of diverse local governments. This process has focused on significant business activities. It does include other local governments, although the process is optional as opposed to mandatory. Queensland's decision to share NCP payments with local government is particularly of note;
- Queensland's development of proposals for pricing oversight of some water service providers by the QCA is a significant step in ensuring transparency and accountability in pricing outcomes;
- there are a number of issues that are presently being refined by the QCA and working group including further principles for the implementation of full cost pricing addressing themes of rates of return, optimisation of assets and treatment of contributed assets; and
- the information provided by the QCA report has greatly assisted the Council in assessing reform. The Council understands that much of the information was based on 1997-1998 financial information and 1998-1999 Budgets and may not provide as current a picture of reform as has actually taken place. Should the Queensland Government adopt the QCA's recommendation that it report in February instead of November, the next QCA assessment (February 2001) should benefit from information concerning two financial years (1998-1999 and 1999-2000).

Assessment

Having regard in particular to the QCA report, the Council has formed the view that despite progress, particularly among the majority of *big 17* local governments, full cost recovery has not been implemented across the urban and non-metropolitan urban water industry, and second tranche commitments have not been met.

In particular, the QCA recommendations as to payments suggest that, while reform has started in most local governments, it has a substantial way to go. The report and detailed assessments also reflect that, in a significant number of cases, reform has not

commenced at all. The Council's view is consistent with the recommendations of the QCA.

However, having regard to the following matters the Council will undertake a further assessment and make recommendation as to NCP payments before 30 June 2000:

- progress, particularly among larger local governments, in implementing reforms;
- systems initiated by the Government to encourage and facilitate reform;
- the further development of guidelines outlined above; and
- the co-operative approach of Queensland in providing information and engaging in discussions throughout the supplementary assessment process.

The Council recommends the following further assessment of Queensland water reform:

1. That the Council undertake a further supplementary assessment prior to 30 June 2000. At that time the Council will examine the following matters:
 - Finalisation of further guidelines by the Technical Issues Working Group in relation to full cost pricing.
 - Finalisation of the QCA's water pricing principles.

The Council notes that Queensland has committed to provide the guidelines and principles to the Council at this time.

- The identification of a timetable to progress reform across those local governments outside the *big 17* with more than 5000 connections. This timetable should include specific actions to provide for reform consistent with commitments. The Council would also look for implementation dates prior to 30 June 2001 and the third tranche assessment.
 - The identification of a strategy to promote reform across remaining local governments. The Council notes that the supplementary assessment will in particular focus on those local governments with greater than 1000 connections and would look to specific actions to promote reform across local governments.
2. The Council will assess the performance of water and sewerage providers against reform commitments during the third tranche assessment. By this time, the QCA should have had the opportunity to assess reform against information provided in local government annual reports for the financial years 1998-1999 and 1999-2000. The Council notes that it will assess cost recovery for water and sewerage businesses as separate activities.

This assessment provides further time for implementation of this commitment. It is consistent with the Council's approach to assessment in other jurisdictions. It will enable the further identification of strategies to promote reform, which should ensure

the best outcomes. It will also permit a rigorous third tranche assessment of reform for all water and sewerage providers.

The Council notes that some reform commitments are being implemented well outside the time initially envisaged by governments when they agreed to the COAG water reforms. While these recommendations focus on the achievement of reform as opposed to strict adherence to agreed timetables, NCP payments recognise the dividend for reform achievement. Should the assessment in June 2000 indicate little further progress, the Council would be likely to recommend to the Treasurer there be a reduction in NCP payments.

Consumption based pricing

Outstanding issue, June 1999

For the *big 17* local governments, the Council was concerned that four (Pine Rivers, Rockhampton, Thuringowa and Townsville) that had not adopted recommendations of independent two-part tariff reviews.

The Council was also concerned at the retention of significant base allowances in many water tariffs; this effectively resulted in a single charge for the majority of water users that was not reflective of consumption and provided no price signal for water use.

The Council was not provided with information concerning the construction of sewerage tariffs, nor the timetable to remove property based sewerage tariffs in Brisbane.

Queensland offered to provide further information following the collection and analysis of this information by the Queensland Competition Authority.

Developments since June 1999

Information provided concerning tariff structures for those local governments with more than 5000 connections is set out at Attachments 3 (the *big 17*) and 4.

QCA report

In addition to the information outlined above, the report noted that metering is now quite extensive across Queensland, providing a sound basis for further implementation of reforms; *‘However, in many instances, free allocations are set at such a high level that only a small proportion of customers face excess metered water charges’*.

Two-part tariff reviews have been completed for all significant business activities except for Bundaberg. Resolutions have been consistent with recommendations except in Pine Rivers, Rockhampton, Thuringowa and Townsville. The QCA noted that while it had reviewed the local governments’ resolutions it had not undertaken the detailed assessment necessary to make a judgement on the reasonableness of the decisions to reject reform; the QCA withheld recommendations pending new two-part tariff reports to be undertaken as required by legislation.

Of the remaining 73 local governments, 41 have commissioned reports and 15 have each received recommendations for full funding after: completing the report; and making resolutions consistent with the report. The QCA noted that the rigour of analysis in these reports is significantly less than the *big 17* reports, the level of understanding of efficient pricing principles varied widely across local governments and although many had begun reforms prior to the beginning of the scheme, a significant percentage of local governments had not provided information.

The QCA noted that the proportion of these local governments which have extensively metered water services is *significantly greater* than the proportion that

have implemented two-part tariffs. It noted that the capacity for reform is therefore not significantly impeded by the cost of metering, the QCA stated that:

'The main hurdle to improved pricing is the existence of significant free water allowances. Allowances are often set in accordance with an estimation of what the average member of a customer group would consume in a normal year'.

Information provided to the QCA indicated that 37 local governments employ free allocations, 24 did not provide information and 12 indicated that free allocations were not used.

Further information provided by Queensland

Brisbane City Council sewerage tariffs

Further information provided by Queensland indicated that Brisbane City Council has resolved to phase out property based charges for sewerage at the earliest opportunity. The information indicated that 7.9 per cent of properties (primarily non-domestic land) charge on a property value basis (that is, 0.328 cents per dollar) raising some 18 per cent of revenues. In addition some of these properties contribute 24.6 per cent of revenues through pedestal charges. Domestic properties are charged a fixed amount (\$243.80). The report noted that:

- *Domestic* sewerage charges in 1999-2000 have increased \$50 *'to more closely align the level of full cost recovery from domestic consumers with the estimated sewerage discharge by domestic properties'*. Detailed cost quantification work will be completed in 1999-2000 with a view to further developing the basis for charges.
- *Non-domestic* properties account for 40.5 per cent of sewerage volume and 46.7 per cent of charges, with 53 per cent being collected from pedestal charges. Brisbane is presently undertaking work that includes an assessment of both outflow volume and strength and research on reform options. It is expected that *'the first steps of reform will be initiated in the 2000-01 financial year, with major steps towards the elimination of valuation (property) based charges and the introduction of full cost recovery within the next three years'*.

Rockhampton, Pine Rivers, Thuringowa and Townsville

Additional information provided by Queensland included: the Pine Rivers Shire Council *Statement of Reasons not to adopt Two-part Tariff Pricing for Water Services*; and the Thuringowa City Council *Evaluation of the Cost Effectiveness of Introducing Two Part Water Tariffs*¹⁵.

¹⁵ AEC 1999A

Rockhampton City Council

The additional information provided by Queensland noted that the AEC report indicated only marginal benefits from the implementation of two-part tariffs and there would be greater community benefit from using the upfront cost of installing water meters to replace and upgrade various parts of the existing infrastructure base. Rockhampton proposes to reconsider the implementation in 2000-2001, prior to the time of any major augmentation (2002, 2009 and 2013-2014). In addition: AEC gave limited consideration to non-financial benefits of implementing two-part tariffs; the community benefit in the economic model is marginal and changing the assumptions could change the outcomes; public consultation was overwhelmingly opposed to the introduction of two-part tariffs; the Council has increased its efforts in a non-financial demand management program; and Rockhampton has made substantial progress in other areas of water, notably with full cost pricing and CSOs.

Queensland submitted that the Council should review progress with respect to two-part tariffs in June 2001.

Pine Rivers Shire Council

The Statement of Reasons provided to the Council noted that the main determinant of future water use in Pine Rivers was expected population growth and future water supply was presently assured. It also noted that there were no compelling reasons to introduce two-part tariffs before July 2001, and sound commercial reasons to continue with detailed assessment of future infrastructure requirements. Other matters included that: all commercial, industrial and larger residential users pay a volumetric charge; the present levy for other consumers is equivalent to the total cost of water supply including TER; a 25 per cent reduction in demand for water over the five previous years was attributed in large part to water demand management strategies, seasonal impacts, price rises and reducing occupancy levels per household; the Shire's water consumption is less than the Queensland average; a majority of residents surveyed rejected the notion of water charging by meters; and charging for water volumetrically could affect amenity. Pine Rivers also questioned the 25 per cent reduction assumed in the AEC report and other assumptions in the report. In addition, it was noted that any infrastructure cost that will be deferred if two-part tariffs are introduced will not be incurred until 2002.

Recommended actions in the Statement of Reasons included finalisation of full cost pricing and completion of a sample assessment of metered consumption for different categories of water consumers to enable identification and disclosure of cross-subsidies. In addition, other recommended action included implementation of a comprehensive non-tariff based demand management system, finalisation of planned infrastructure costs over the next twenty years and trialing a number of reticulation system leak detection approaches. The Statement of Reasons also recommended that, prior to July 2001, a trial be conducted to assess more confidently the impact on water demand from any move to comprehensive water metering and two-part tariff pricing, reassessment of the net present value of benefits to be gained from introducing two-part tariffs and undertaking a revenue assessment to ensure that if a two-part tariff is recommended the Shire has taken full account of water demand elasticity and price issues prior to establishing a particular tariff regime.

Townsville and Thuringowa City Councils

The Thuringowa City Council two-part tariff report found that the net present value in cost savings accruing from the introduction of a two-part tariff was about \$7.3m over the twenty year analysis period assuming a 20 per cent reduction in per capita consumption and using a six per cent real discount rate. The report notes in its recommendations that *'as all consumers are granted the opportunity to choose their consumption mix based on a transparent and accurate pricing regime [that is, two-part tariffs] a superior outcome will be achieved and ensure the maximum community return from the resource'*. In addition, the *end user philosophy* has equity considerations as each user pays only for the water they use, eliminating cross-subsidies from low to high user groups. The report concluded that the introduction of a two-part tariff *'is the most cost effective, equitable, efficient and sociably desirable technique to charge for the provision of water supply services'*, and accordingly recommended that it be adopted.

It is of note that this report precedes the *Further considerations for the evaluation of introducing a Two Part Tariff in Townsville*¹⁶. That report raised a number of issues that emerged from the practical application of the *Guidelines for Evaluation of Introducing and Improving Two Part Tariffs*¹⁷.

The first issue was the use of Short Run Marginal Cost pricing for the design of the volumetric charge under a two-part tariff.

The second issue was *'the interdependent analysis required and uncertainty generated where a Water Board (potentially serving multiple systems) holds responsibility for infrastructure as is the case in Townsville and Thuringowa'*. In this respect the report noted that the legislative requirements for two-part tariff assessments do not permit as comprehensive analysis as would be desirable because separate assessments must be carried out.

Given these concerns AEC recommended that a cost effectiveness evaluation be undertaken on the united water business encompassing Townsville and Thuringowa City Councils and the Townsville Thuringowa Water Board before either city implement a two-part tariff in isolation.

Queensland provided additional information concerning the considerations of both Townsville and Thuringowa in not implementing two-part tariffs, addressing matters such as community attitudes, local government amenity and implementation of other water reforms. No information was provided addressing the final recommendation of AEC.

Local Governments outside the big 17

In respect of the local governments outside the big 17, 84 are metered and 22 of these already have two-part tariffs in place. Of the 53 local governments with more than 1000 connections, 35 either have a two-part tariff, have completed a two-part tariff

¹⁶ AEC 1999B

¹⁷ DNR 1997

assessment or are planning an assessment. The remainder have funds available to undertake an assessment should they so resolve.

Table 2: Summary of base allowances of 108 local governments

Base allowance	Percentage of water connections within the base allowance range
1-300kL per year	18.26 per cent
301-600kL per year	59.42 per cent
601-900kL per year	12.41 per cent
901 plus kL per year	9.91 per cent

While recognising that many local governments have metered arrangements including a base allowance, Queensland advised that ‘78% of base allowances are equal to or below Queensland’s average household consumption rate of 600kL per year, providing some price incentive to households to conserve water’.

Other matters

Additional program to encourage reform

The Council has been advised that the Department of Communication, Information, Local Government and Planning (DCILGP) has indicated it will be instigating discussions with those local governments which are yet to consider two-part tariffs to complete a review. All local governments who have nominated COAG water reform as part of QCA assessment process are to be included.

Supreme Court Decision

In a decision of the Queensland Supreme Court in *Hume Doors and Timber (QLD) P/L v Logan City Council* (Unreported, Supreme Court of Queensland (Chesterman J), 26 November 1999) the Court held that charges levied on the plaintiff by Logan City Council (Logan) for water services were invalid. Logan had resolved to implement a two-part tariff. The Court found that the tariff imposed on the plaintiff included only a component for access, based on meter size. It was some thirty times the applicant’s previous water charge.

The first reason the tariff was invalid was that Logan failed to ensure an assessment of the cost effectiveness of the application of the tariff was carried out and a report prepared, as required by the LG Act. Although consultants had prepared a report, it did not address the criteria identified in the legislation. The Court found that this was a precondition to a decision of a local government to adopt a two-part tariff.

The second reason was that the tariff levied against the plaintiff contained no component for consumption. The Court found that the LG Act required that where a local government adopts a two-part tariff it must make consumption the basis of the charge.

Discussion

As with the implementation of full cost recovery, the Council notes that Queensland has made gradual progress in implementing consumption based pricing. Again, this

progress is heavily concentrated in the larger local governments which are required to assess the cost effectiveness of reform.

As with its assessment of cost recovery, the Council has not undertaken a detailed assessment of the tariff structures of every local government, but instead has reviewed the information provided and the report of the QCA. In particular, the Council has focused on larger providers.

Big 17

The information provided to the Council demonstrates that 11 of the *big 17* local government water service providers have implemented two part tariffs without base allowances. Of the remaining six, two (Gold Coast and Mackay) have identified timetables that will see the removal of base allowances by 2000-2001.

In respect of Pine Rivers and Rockhampton, Queensland has noted that these Councils will re-assess the cost effectiveness of implementing two-part tariff reform prior to June 2001. This is prior to any augmentation costs that may be incurred if the tariff reforms are not implemented. In addition, both local governments have identified other initiatives to increase the efficiency of water supply services and the consciousness of consumers as to their water use. The Council notes that the assessment of the QCA in withholding recommendation for payments to these local governments and Townsville and Thuringowa is consistent with its own approach to reassess reform in supplementary assessments.

In addition, the information provided indicates that, except for some tariffs in Brisbane, sewerage charges are not based on property prices,. It is noted that Queensland has advised that sewerage prices have been based on full cost pricing.

For Brisbane, Queensland has provided detailed information on the manner in which tariffs will be reviewed and reformed.

Greater than 5000 connections (other than the big 17)

Of the next 11 local governments (greater than 5000 connections) the Council notes that only one, Warwick, has no base allowance in its tariff structure. Base allowances for the other local governments range from 130-1040kL. The QCA detailed assessments and information from Queensland suggest that:

- two local governments (Beaudesert and Gladstone) have in principle agreed to tariff reform. While the implementation date for Beaudesert (1999-2000) is clear, the date of implementation for Gladstone (after 1999-2000) has not been specified;
- three local governments (Burdekin, Bundaberg and Cooloola) are considering two-part tariff reports;
- two local governments (Maryborough and Livingstone) have commissioned reports regarding the implementation of two-part tariffs; and
- the remaining local governments (Johnstone, Mt Isa and Redcliffe) have either not commissioned or have resolved not to commission a two-part tariff report.

The QCA detailed assessments indicate that in some cases, only a very small number of customers face a volumetric component in their water charges. For example, in Bundaberg, where the base allowance is 600kL, only 3 per cent of domestic water consumption is subject to excess charges. In Gladstone (base allowance 500kL), only 11% of the proportion of water supplied to customer groups attracts an excess charge. It is clear that the majority of water users pay no volumetric component whatever. The slow progress of tariff reform amongst these local governments is reflected in the QCA recommendations: only Warwick was recommended to receive greater than 20 per cent of cap.

The arrangements for local governments other than Warwick are inconsistent with reform commitments. The Council agrees with the view of the QCA that free water allowances are a significant hurdle to improved pricing. They are inconsistent with efficient pricing and have a strong potential to distort consumption patterns leading to inefficient use of water. They also have a strong tendency to result in cross-subsidies between customer classes, and are inconsistent with consumption based pricing and therefore with water reform commitments..

Other local governments

Amongst local governments with greater than 1000 connections, a significant number (for example, Boonah, Calliope, Crows Nest, Fitzroy, Gatton, Hinchinbrook, Jondaryan, Kingaroy, Pittsworth, Rosalie and Stanthorpe) have a two-part tariff with no base allowance. Other local governments (for example, Burnett, Esk, Murgon, Nanango and Paroo) have resolved to implement two part tariffs. However, many local governments are still only at the stage of commissioning reviews.

Some local governments have not resolved to implement reforms and one local government (Longreach) has advised that it has no intention to furthering reforms following a rejection by customers of a reduced base allowance (from 1200kL). Such an approach appears inconsistent with reform commitments to implement two-part tariffs where cost-effective.

Other matters

In addition to matters previously noted by the Council, the following are relevant to the assessment:

- in 1994, Governments agreed that they would implement consumption based pricing, including two part tariffs where cost effective, by 1998. The further information provided by Queensland, although demonstrating progress particularly with the largest providers also indicates some significant delays, particularly where reform is being encouraged as opposed to required;
- Queensland has in place a process to inform, support, monitor and encourage reforms, including guidelines and funding for the assessment and introduction of two-part tariffs. This includes the additional program of the DCILGP to encourage local governments to complete two-part tariff reviews;
- the recent decision of the Queensland Supreme Court may require the Government to make a legislative response to ensure the validity of tariffs based on two-part

tariff reviews. Such a response will inevitably take some time to formulate and place before the Parliament for consideration. The Council considers this an exceptional event which requires a sensitive assessment on the Council's part; and

- the Council has not been provided with information concerning those local governments that have rejected recommendations for two-part tariffs made following reviews. Nor has the Council been provided with information concerning those reviews where two-part tariffs were found not to be cost effective. Given the concerns of the QCA the Council requires this information.

Assessment

Having regard in particular to the QCA report, the Council is of the view that despite progress across some service providers, and in particular large service providers, consumption based pricing has not been implemented across the urban and non-metropolitan urban water industry. The Council is not satisfied that this reform commitment, due in 1998, has been met.

In particular, the QCA payment recommendations indicate that reforms have been implemented in many large local governments, not implemented in some of the *big 17*, and have had only a limited take-up in local governments outside this group.

While the Council accepts arguments made by Queensland to not reassess tariff reform in Rockhampton and Pine Rivers until the third tranche assessment, it remains of the view that Queensland has not provided a response that addresses the issues raised in reforming tariffs in Townsville and Thuringowa. In particular, no information has been provided to address the final AEC recommendation of a review of these local governments and the Townsville-Thuringowa Water Board jointly.

The Council notes that the next 11 local governments are all of a significant size and service a population of more than 300 000 persons. Only one of these local governments, Warwick, has been recommended to receive a significant proportion of its cap payments for water reform.

However, having regard to the following matters the Council will undertake a further assessment and make recommendation as to NCP payments before 30 June 2000:

- progress, particularly among larger local governments, in implementing reforms;
- the recent decision of the Supreme Court in *Hume Doors*, which in all likelihood will require a response from the Queensland Government;
- systems initiated by Government to encourage and facilitate reform. This includes the additional program to encourage those local governments which are yet to consider two-part tariffs to complete a review; and
- the co-operative approach of Queensland in providing information and engaging in discussions throughout the supplementary assessment process.

The Council recommends the following further assessment of reform against this commitment:

3. That the Council undertake a further supplementary assessment prior to 30 June 2000. At that time the Council will examine the following matters:
 - the response to the AEC recommendation that there be a cost effectiveness evaluation on the united water business encompassing Townsville and Thuringowa City Councils and the Townsville-Thuringowa Water Board.
 - information concerning tariff reforms for other local governments including:
 - = identifying those local governments that have undertaken two-part tariff reviews;
 - = identifying those local governments that have resolved to implement two-part tariffs following the reviews;
 - = identifying those local governments that have resolved not to adopt two-part tariff review recommendations where the recommendation was that such a tariff be adopted, and providing a copy of the review and relevant reasons and recommendations of local governments; and
 - = providing copies of two-part tariff reviews where the recommendation was that a two-part tariff not be adopted.
 - the identification of a timetable to progress reform across those local governments outside the *big 17* with more than 5000 connections. This timetable should include specific actions to provide for the implementation of two-part tariffs and removal of base allowances where required by reform commitments. The Council would also look for implementation dates prior to 30 June 2001 and the third tranche assessment.
 - the identification of a strategy to promote reform across remaining local governments. The Council notes that the supplementary assessment will in particular focus on those local governments with greater than 1000 connections and would look to specific actions to promote reform across local governments, including implementation of two part tariffs and removal of base allowances where required by reform commitments.
4. The Council notes that it will again assess performance of water and sewerage providers against reform commitments during the third tranche assessment. By this time, the QCA should have had the opportunity to assess reform against information provided in local government annual reports for the financial years 1998-1999 and 1999-2000. The Council will reassess the progress of the local governments of Rockhampton and Pine Rivers. It would look for both a further evaluation of two-part tariff reform and a relevant local government resolutions. The progress of Brisbane in reforming sewerage tariffs against the timetable provided will also be assessed in the third tranche.

As with its recommendations concerning cost recovery, the Council is of the view that this assessment, in providing further time to implement reforms, enables Queensland to work towards the best outcomes through tariff reform. It will also promote a

rigorous third tranche assessment of reform for local government service providers. The Council is also notes that it is consistent with the Council's approach to assessment in other jurisdictions.

The Council again notes that some reform commitments are being implemented well outside the time initially envisaged by governments when they agreed to the COAG water reforms. While these recommendations focus on the achievement of reform as opposed to strict adherence to agreed timetables, NCP payments recognise the dividend from reform achievement. Should the assessment in June 2000 indicate little further progress, the Council would be likely to recommend to the Treasurer that there be a reduction in NCP payments.

Cross-subsidies

Outstanding issue, June 1999

The Council considered that the *Guidelines for identification and measurement of cross-subsidies* provided a consistent basis for local governments to assess and evaluate cross-subsidies. It noted concerns, however, regarding the failure to implement two-part tariffs, the existence of significant base allowances and the lack of information regarding cross-subsidisation between water and sewerage providers.

Developments since June 1999

QCA report

The QCA report notes that significant businesses are required to disclose cross-subsidies between domestic, commercial, industrial and other customer classes on or before 1 July 2000, or at a time to be determined by the Minister. The report notes that progress on the issue is mixed, and that implementation will significantly increase over the next two years as legislative requirements take effect.

15 of the 18 significant business activities and 7 other water and sewerage activities received partial funding recommendations for disclosure of CSOs or cross-subsidies.

Further Queensland information

Further information from Queensland indicated that the implementation of two-part tariffs by 13 of the *big 17* local governments will have minimised the opportunity for cross-subsidies between customer classes. The commitment by Brisbane to phase out remaining property based tariffs will also further reduce the potential for cross-subsidisation. Any remaining price discrimination/cross-subsidies will be reported publicly by all of the *big 17* from 1 July 2000. This date has been chosen to enable local governments to implement necessary information systems to identify customer groups and fully calculate the extent of cross-subsidies.

Queensland stated that of the remaining 108 local governments, there was a lack of property based charges which suggest substantial cross-subsidies between customer classes. In addition there is a high level of metering. Local governments will continue to be encouraged to review charging arrangements through the NCP Local Government Finance Incentive Package.

Assessment

The information provided to the Council has not progressed substantially from the second tranche assessment. This was in large part to be expected, given that local governments are not required to formally report against this reform commitment until after June 2000.

While accepting that tariff structures amongst the majority of the *big 17* local governments should result in the minimisation of cross-subsidies, the Council notes that the large majority of other local governments, including ten out of the next 11 in

size, retain base allowances that will in some cases have a strong potential for cross-subsidisation by low water users. This is evidenced by the findings of the QCA.

For those local governments that do not report separately on water and sewerage services, the Council cannot conclude that there is no cross-subsidisation between water and sewerage customers and businesses.

Because local governments have not reported on cross-subsidies and subsidies, the Council is unable to assess Queensland as having met its reform commitments for the second tranche assessment.

The Council's assessment is informed principally by Queensland's process to identify and report on cross-subsidies. This path forward will enable the Council to assess progress in 2001 with a high degree of rigour. In addition, the Council will be significantly assisted by information provided to and assessed by the QCA at this time.

Therefore, the Council recommends that no further assessment of this reform commitment take place until the third tranche assessment.

The Council notes that it is to reassess progress of the working group and QCA in relation to other aspects of the pricing principles prior to June 2000, and that this should provide further assistance to local governments in implementing reforms including reforms in relation to cross-subsidies.

Where water and sewerage services are not reported on separately, Queensland will need to either demonstrate that there is no cross-subsidy or alternatively that it is transparently reported. In addition, where base allowances remain it will be incumbent on Queensland to demonstrate that there is no cross-subsidy between customer groups or alternatively that it is transparently reported. This is in addition to the other pricing reform commitments.

Community service obligations.

Outstanding issue, June 1999

The Council noted that the provisions of the LG Act provided a framework for local governments to identify and cost CSOs. However, very little information was provided on the application of the CSO policy.

Developments since June 1999

The information provided concerning CSO schemes of the *big 17* local governments is set out at Attachment 5.

QCA report

The QCA noted that, while significant businesses are specifically required to identify and disclose CSOs on or before 1 July 2000, all have applied either commercialisation or full cost recovery pricing and therefore have been required to implement CSO arrangements prior to this date. Although other water and sewerage businesses have no specific requirements, generally similar requirements apply to these local governments.

As noted above, 15 of the 18 significant business activities and 7 other water and sewerage activities received partial funding recommendations for disclosure of CSOs or cross-subsidies, and because of legislative requirements progress on this issue was mixed. Identification and quantification of CSOs has often been undertaken in the context of performance or operating plans as part of a commercialisation process.

Further Queensland information

Queensland noted that CSOs are provided for pensioner rebates, fire fighting, community groups and beach showers at Caloundra. They are funded from local government consolidated funds or by the Department of Families, Youth and Community Care (DFYCC).

The DFYCC subsidy to approved pensioners is 20 per cent of the gross rates and charges levied by local government with a cap on the total amount of assistance. The cap varies from local government to local government depending on the total rates levied¹⁸. The subsidy is paid direct to local government to be passed on to approved pensioner ratepayers.

The working group is currently developing CSO guidelines for local government to further assist in the definition and costing of CSOs, and these will be used by the QCA for its upcoming assessments.

¹⁸ Information provided by Queensland on 21 December 1999

Assessment

The Council has reviewed the additional information provided and notes the substantial variation between CSOs from local government to local government. The explanations provided by Queensland demonstrate that those payments identified as CSOs are clearly defined. Some (for example, Caboolture and Mackay) are of a transitory nature and assist in reform implementation while other are targeted at specific community activities or groups (for example, pensioners). The payment by the State Government of pensioner rebates is also consistent with reform commitments.

The progress of the working group and QCA on water pricing principles should further assist local governments and Queensland in implementing reform. The Council has noted it will examine these in the supplementary June 2000 assessment.

The Council is otherwise satisfied that Queensland has met its reform commitments for the second tranche assessment.

Real rate of return

Outstanding issue, June 1999

While some service providers appeared to earn a positive rate of return the information provided in relation to other service providers did not lend itself to any conclusions. In addition, the basis of asset valuations was not clear.

Developments since June 1999

Further Queensland information

Queensland noted that all of the *big 17* local governments had valued their assets consistent with a deprival value approach, assets being valued either by local governments or independent consultants and the valuations being signed-off the Auditor General. The majority of the *big 17* are earning RoR, although there is some variation in the method of depreciation; these issues should be resolved by the QCA in forthcoming assessments.

Assessment

The Council is of the view that the *big 17* have largely met reform commitments. However, it has not been provided with significant information concerning the remaining local governments and hence cannot arrive at any conclusion concerning these providers.

The Council, while of the view that there has been progress in achieving positive real RoR, is not of the view that this reform commitment has been met. The Council will undertake a further assessment and make recommendation as to NCP payments before 30 June 2000.

The Council has outlined in detail above the matters it will assess at that time. Further guidelines to be developed by the QCA and working group are particularly relevant to this reform commitment. As noted above, the Council will also have a further opportunity to assess reform during the third tranche assessment process.

Rural schemes

Outstanding issue, June 1999

The Council was concerned that certain rural projects had not been subjected to robust independent appraisal processes to determine the economic viability and/or ecological sustainability prior to investment in them. The specific rural schemes are: Bedford Weir Stage II; Bingegang Weir Stage II; Dumbleton Weir Stage III; Mareeba-Dimbulah Irrigation Area; Moura off-stream storage; St George off-stream storage; Walla Weir; and Warrill Creek Diversion Weir.

The Council recommended a suspension of 25 percent of Queensland's competition payments for the year 1999-2000 until December 1999 when it proposed to make a final recommendation on any reduction in competition payment that would be made to Queensland for any schemes that it was not satisfied had proceeded in a manner consistent with reform commitments.

Since June 1999 the Council has requested and reviewed further information and sought a path forward to resolve any concerns.

Developments since June 1999

Specific schemes

The Council was provided with further information concerning all additional rural schemes except the St George off-stream storage. A summary of that further information for each scheme and the Council's further assessment is at Attachment 6.

The Queensland Treasurer wrote to the Council on 15 December 1999 advising that the Government was not to proceed with the St George off-stream storage. The Treasurer stated that the Government will address water security and reliability issues by way of a *buy back* of some existing water allocations and adjustment to water management rules. The Treasurer also noted that the Government is preparing guidelines for the development of small rural schemes prior to Water Allocation and Management Plans/Water Management Plans. These will be provided to the Council prior to the June 2000 supplementary assessment.

The Council was not provided with any further information by Queensland concerning the St George off-stream storage to progress concerns outlined in the second tranche assessment. However, having regard to the advice that the project is not to proceed, there is nothing to assess against this reform commitment.

Guidelines

A letter from the A/Under Treasurer to the Council¹⁹ advised the following *key deliverables* will be available for the Council's assessment in June 2000.

¹⁹ 15 October 1999

Environmental Impact Assessment

In response to the Council's concerns regarding the completion of environmental impact assessments by water service providers, and the apparent lack of consistency within DNR regarding responsibility for the completion of environmental impact assessments, the Queensland Government:

' ... proposes to develop guidelines to streamline the completion of environmental impact assessment for new projects. These guidelines will, amongst other things, outline arrangements for independent appraisal of environmental impacts by either independent consultants or by the Resource Regulator within DNR.

Further, the Queensland Government notes that the new resource management regulatory framework (as outlined in the Water Allocation and Management Bill), with a clearly defined resource management regulator, should address many of the NCC's concerns with respect to the resource management approvals for new projects'.

Economic Assessment

In respect of concerns raised by the Council regarding economic viability assessments of new rural schemes, the Queensland Government:

'... proposes to develop additional economic evaluation guidelines²⁰ specifically for evaluation of new rural water projects. The guidelines would, amongst other things, address:

- evaluation of the level of cost recovery for new projects;*
- the relationship between economic assessment of new projects and the Queensland Treasury Community Service Obligation Guidelines; and*
- require that the results of the economic assessments are reported in a transparent manner'.*

Discussion

The following table provides a very brief summary of the assessment of the Council in respect of rural projects which raised concerns during the second tranche assessment.

²⁰ i.e., in addition the Queensland Treasury Project Evaluation Guidelines (Queensland Treasury, 1997)

Table 3: Summary of Council Assessments, new rural schemes

Scheme	Ecological Sustainability	Economic Viability
Bedford Weir Stage II	Review following completion of Fitzroy WAMP	Assessment concerns addressed by additional information
Bingegang Weir Stage II	Review following completion of Fitzroy WAMP	Review following sale of water allocations
Dumbleton Weir Stage III	Assessment concerns addressed by additional information	Review following sale of water allocations
Mareeba-Dimbulah Irrigation Area Augmentation	Assessment concerns addressed by additional information	Assessment concerns addressed by additional information
Moura off-stream storage	Assessment concerns addressed by additional information	N/A
Walla Weir	N/A	Not an assessable scheme
Warrill Creek Junction Weir	Assessment concerns addressed by additional information	Assessment concerns addressed by additional information

The Council noted the constructive and forward looking proposals of Queensland to develop new guidelines for the assessment of ecological sustainability and economic viability. The Council is of the view that appropriate Guidelines properly applied will ensure that the concerns that have arisen throughout the second tranche assessment should not arise again.

The Council has raised with Queensland on a number of occasions its concern that projects have been assessed, approved, commenced and completed throughout the period that WAMPs for the catchments are being developed. Examples of these projects include the Bedford Weir Stage II and Bingegang Weir Stage II. The Council has advised Queensland that in such cases, and should the WAMP indicate that there is insufficient allowance for the environment because of the scheme, it is the Council's view that Queensland will have failed to meet its reform commitments.

Queensland has advised that it will develop guidelines concerning small rural schemes progressing prior to the completion of a WAMP. It is the Council's preliminary view that a better policy response would be for no new infrastructure to be completed in WAMP/WMP catchments until the completion of the relevant Plan. The Council will progress this matter with Queensland during the period prior to the June 2000 supplementary assessment.

Assessment

1. Other than those matters noted for further assessment prior to the third tranche assessment, and given the commitment given by Queensland as to the future conduct of economic and ecological assessments, the Council is satisfied that the schemes outlined above have progressed in a manner consistent with reform obligations, or alternatively that there should be no reduction recommended in NCP payments to Queensland.
2. The Council will assess the Guidelines for development of small rural water schemes, ecological sustainability and economic viability proposed by Queensland as part of the supplementary assessment in June 2000.

3. The Council recommends that the suspension of 25 percent of NCP payments for the year 1999-2000 be lifted.
4. The Council recommends that there be no reduction in NCP payments in respect of this reform commitment for the period 1 January 2000 to 30 June 2000.

Management of irrigation areas

Outstanding issue, June 1999

The present advisory or interim arrangements in Queensland did not provide for devolution of operational management other than to a small extent. The Council indicated that it would look to development and some implementation of further local management in irrigation areas, with a firm timetable identified to complete this process.

Developments since June 1999

As is outlined below, the Council has been provided with a draft discussion paper concerning the structural reform of State Water Projects (SWP). The paper canvasses the options for local management of irrigation areas. The proposal includes the creation of Customer Councils to advise on matters such as strategic planning, Customer Service Agreement negotiation, prioritisation of asset investment and refurbishment and other customer service issues.

The discussion paper notes that user management of schemes will be offered (through the creation of water boards) where there are likely to be substantial and mutual benefits to users and government.

The proposed date for commencement of reforms for SWP is 1 July 2000.

Assessment

1. At this time, Queensland has not met its reform commitments as regards management of irrigation areas.
2. Nevertheless, given the ongoing progress of reforms and the clear path identified to see the institutional reform process through, the Council will undertake a further assessment and make recommendation as to NCP payments before 30 June 2000.
3. At 30 June 2000, the Council would assess Queensland's compliance with commitments having particular regard to the following matters:
 - satisfactory resolution of concerns raised by the Council as the legislation and reforms are further developed and finalised; and
 - passage of identified legislation and other reforms.

REFORM COMMITMENT: INSTITUTIONAL REFORM

Institutional Role Separation

Outstanding issue, June 1999

Viewed as a whole, the institutional frameworks in the Queensland water industry fell well short of the strategic framework requirements to separate service providers from regulatory, standard setting and resource management functions.

The Council indicated that it would look to progress in the following areas in assessing Queensland's compliance with reform commitments in December 1999:

- amendments to the QCA Act to provide for the oversight of prices charged by local government water and wastewater providers;
- significant legislative or administrative progress on the implementation of licensing or other standard setting mechanisms; and
- significant progress on the review and implementation of new institutional arrangements for SWP.

Developments since June 1999

Queensland Competition Authority Amendment Bill 1999

The Council has been provided with a copy of this Bill.

This Bill proposes a role for the QCA in price setting for certain water providers, through a deterministic prices oversight regime for private water suppliers and recommendatory oversight for publicly owned (that is, state and local government) water suppliers.

In addition, the Bill permits third parties to access water held privately where the proposed water provider has market power. It will in effect allow the QCA to mediate or arbitrate leasing of water by someone else in certain circumstances.

Water (Infrastructure and Service Regulation) Bill

The Council has been provided with drafting instructions for this Bill.

This Bill provides for a regulatory framework for the Queensland water industry. It both consolidates and builds on provisions in, for example, the Water Resources Act and the instructions have regard to other legislative initiatives (for example, the Water Allocation and Management Bill).

The general approach outlined in the Bill is described as a *risk management-based process* which pushes accountability back on the industry through plans and reporting requirements. It is an audit based system. The focus includes ensuring that customers are informed about the terms and conditions of the service provided.

Attachment 7 is a diagram of the proposed regulatory framework.

The proposed scheme is distinct from arrangements in other jurisdictions in that it provides for registration rather than licensing. Water service providers (WSPs) register their water business (water service providers must be registered). Registered WSPs:

- develop infrastructure standards and plans to support those standards to ensure continuity of supply; and
- submit the standards and plans to the Regulator.

The Regulator may require audits, undertake audits and require rectification of matters.

In addition, WSPs must develop and distribute customer standards and report to the Regulator on performance against these standards on an annual basis (it is noted that the Regulator may publish these results). The Regulator can specify what is in customer standards and impose customer standards on providers other than *elected bodies* such as local governments. Customer Councils must be established to advise on standards etc.

Councils with less than 500 connections can be exempted from compliance by the Regulator.

The Bill provides for declared areas. A declared water supply area, for example, means an area within a local government area in which a WSP is prepared to provide water supply services and which has been declared to be a water supply area by the relevant local government. In declared areas a property owner can request connection to a water supplier, and a local government may require a property owner to connect to infrastructure.

The Bill also relevantly provides for the Regulator to approve the construction, alteration, maintenance, repair, abandonment or removal of referable dams²¹, to attach conditions to the dams and to require the dam owner to take specified action.

The drafting instructions note that, having regard to other legislation and proposed legislation, a WSP who wishes to construct and operate a referable dam would need to: apply to the Department of Natural Resources (DNR) for a water allocation; carry out a hazard assessment and seek acceptance of the assessment by the Regulator; apply to the local government for approval (with DNR as the concurrence agency); apply to DNR for a referable dam licence.

The proposed commencement date for the reforms is 1 July 2000 with a two to four year implementation period.

²¹ i.e., dams that have a significant, high or extreme danger risk as defined

State Water Projects structural reform

The Council has been provided with a draft discussion paper concerning the structural reform of SWP.

The discussion paper canvasses the various reform options for SWP, the present commercialised DNR WSP.

The paper discusses the problems with the existing structure (that is, revolving around conflicting institutional objectives) and options for reform (Statutory Authority /Statutory Government Owned Corporation (GOC)/Company GOC), preferring the Statutory GOC model.

The paper also canvasses the options for local management of irrigation areas. The proposal includes the creation of Customer Councils to advise on matters such as strategic planning, Customer Service Agreement negotiation, prioritisation of asset investment and refurbishment and other customer service issues.

The discussion paper notes that user management of schemes will be offered (through the creation of water boards) where there are likely to be substantial and mutual benefits to users and government.

The proposed date for commencement of reforms for SWP is 1 July 2000.

Water (Statutory Authorities) Bill

The Council has been provided with drafting instructions for this Bill.

The proposed legislation provides a framework by which water service authorities (primarily existing water and drainage boards) may be continued, established, modified or dissolved. It also provides that authorities are to operate according to principles of efficiency and appropriate governance arrangements, accountability requirements and community involvement.

The drafting instructions provide for the establishment of authorities, composition of a Board of Directors (nomination or election), powers and functions of a Board, duties and liabilities of Directors, performance of authorities (for example, key objectives of commercial authority, performance plans and CSOs), powers of the Minister (notification of a public sector policy/directions in the public interest/directions to support the restructure of the water industry) and Consultative Committees and Customer Service Councils.

The proposed implementation date for the Bill is 1 July 2000.

Health regulation

Queensland has provided additional information concerning present regulation of drinking water standards.

This information notes the following relevant matters:

- Queensland Health, the regulatory agency for public health matters, has powers to deal with health related problems arising from contaminated drinking water. It encourages WSPs to incorporate a risk management based approach to supply of drinking water (based on the *Australian Drinking Water Guidelines (1996)*) including catchment management, water treatment processes and maintenance of distribution systems. Queensland Health provides a free water sampling and testing service for WSPs without access to testing facilities, and all water quality sample results are forwarded to the Public Health Network for checking.
- The Minister for Health has extensive powers under the *Health Act 1937* to take any necessary action in the event of an emergency, for example, where there is evidence of a risk to public health.
- At an operational level, much of the responsibility rests with local government WSPs, who are responsible to their electors and also have common law responsibilities.
- An Expert Group has been established to: provide advice for decisions regarding public health aspects of water use in Queensland; consider the feasibility of requiring WSPs to prepare water quality management plans (in the context of a review of the Health Act).

The Queensland government is participating in the current national review of the *Australian Drinking Water Guidelines*.

Other material

The Council has been provided with the *Water (Allocation and Management) Bill 2000*, which provides for the planning, allocation and management and use of water. This Bill is a development from the drafting instructions provided to the Council shortly before the second tranche assessment in June 1999.

The Council has also been provided with Draft Policy Paper (the gold book) entitled *Improved Planning for the Supply of Water in Queensland*. The gold book outlines a planning process to deal with the granting of new allocation in catchments where opportunities for future allocations have been identified.

Discussion

In its second tranche assessment, the Council noted that institutional structures with rigorous institutional separation may include:

- an independent price regulator;
- a resource manager with catchment management functions;
- a licensed water service provider independently regulated by an auditing body;
- an independent mechanism to resolve complaints that cannot be dealt with locally;
- a customer charter and consultative committee;

- an independent water quality regulator; and
- transparency in the above arrangements.

The Council noted that it was these types of features that it would look to in the institutional arrangements to be put in place for WSPs in Queensland.

The proposed arrangements outlined above are broadly consistent with the indicators outlined by the Council. In addition, the ongoing progress across institutional structures provides compelling evidence of the commitment of the Queensland Government to arrive at arrangements that are both rigorous and sensitive to the particular needs of State and local government and the people they serve.

The Council has raised specific matters with Queensland concerning the reforms. These concerns revolve around the degree of separation between the regulators and State and local government WSPs and include:

- the proposed role of local government setting some customer service standards;
- the Minister for Natural Resources being a proposed shareholder should SWP be corporatised; and
- the Regulator being the CEO of DNR or in the office of DNR.

The Council has sought a commitment from Queensland to work through these and any other outstanding issues that may arise as the various legislation is finalised and provided to the Council for comment.

Assessment

1. At this time, Queensland has not met the water reform commitment to separate institutionally as far as possible by 1998 the roles of service provision on the one hand and water resource management, standard setting and regulatory enforcement on the other.
2. Nevertheless, given the ongoing progress of reforms and the clear path identified to see the institutional reform process through, the Council will undertake a further assessment and make recommendation as to NCP payments before 30 June 2000.
3. At 30 June 2000, the Council will assess Queensland's compliance with commitments having particular regard to the following matters:
 - satisfactory resolution of concerns raised by the Council as the legislation and reforms are further developed and finalised; and
 - passage of identified legislation and other reforms.

Attachment 1: Big 17 Local Government - Full Cost Pricing for Water And Sewerage – 1998-99

Council		Total Revenue	OMA	Dep'n	EBIT	Interest	TERs²²
Brisbane²³	Total	370,708,000	333,342,000 ²⁴	1,679,000	35,687,000	N/A	13,116,00
Caboolture	Water	20,535,060	4,425,881	3,526,962	12,582,217	99,993	2,035,88
	Sewerage	24,938,582	4,328,402	4,187,718	16,422,462	62,028	2,621,68
	Total	45,473,642	8,754,283	7,714,680	29,004,679	162,021	4,657,56
Cairns	Water	15,675,681	5,037,439	6,138,669	4,499,573	2,306,217	2,883,70
	Sewerage	18,195,598	5,866,886	3,480,931	8,847,781	3,639,099	4,006,92
	Total	33,871,279	10,904,325	9,619,600	13,347,354	5,945,316	6,890,62
Caloundra	Water	11,066,896	5,891,768	184,618	4,990,510	157,252	27,43
	Sewerage	12,975,617	5,693,264	240,077	7,042,276	838,555	56,29
	Total	24,042,513	11,585,032	424,695 ²⁶	12,032,786	995,807	28,85

²² The taxation figures provided for the big 17 local governments reflect provisions for taxation recorded by each council. Tax payable tax assessors. In this respect, in 1998-99, the actual tax paid may be higher than the tax provision based on whether or not the tax assessor councils for 1998-99. The issue of tax depreciation is a "one-off" and reflects issues associated with initial entry into the tax equivalent payable, will most likely reflect the longer term tax liability of the individual businesses.

²³ Brisbane Water operates and reports as a consolidated water and sewerage supply business

²⁴ Brisbane Water has a franchise agreement with the Brisbane City Council for the provision of water services. Brisbane Water pays a renewals annuity, interest on assets and a rate of return on assets. Brisbane Water has advised of the interest payments and return on confidence basis.

²⁵ Rate of return reflect CSO policy of the Caboolture City Council (i.e. a CSO paid by Caboolture of \$11 million to cover tax equivalent cost pricing.

²⁶ During the 1998/99 financial year Caloundra City Council undertook a comprehensive asset identification and valuation exercise to which assets were only taken to account at 30 June 1999 and the depreciation charges that were recognised in the operating statement of the 1994.

Council		Total Revenue	OMA	Dep'n	EBIT	Interest	TERs ²²
Gold Coast	Water	75,171,000	17,797,000	12,835,000	44,539,000	1,901,000	294,00
	Sewerage	81,859,000	23,000,000	14,165,000	44,694,000	3,034,000	197,00
	Total	157,030,000	40,797,000	27,000,000	89,233,000	4,935,000	491,00
Hervey Bay	Water	7,544,588	3,678,698	932,133	2,933,757	728,852	75,00
	Sewerage	7,889,152	4,126,528	950,482	2,812,142	605,058	65,00
	Total	15,433,740	7,805,226	1,882,615	5,745,899	1,333,910	140,00
Ipswich	Total	41,253,864	20,113,355	1,527,312	19,613,197	856,650	165,52
Logan²⁷	Total	45,425,559	29,691,044	12,200,012	3,534,503	-	
Mackay	Water	9,822,566	4,994,973	1,745,800	3,081,793	658,730	709,00
	Sewerage	10,431,026	4,301,086	1,417,239	4,712,701	726,423	837,00
	Total	20,253,592	9,296,059	3,163,039	7,794,494	1,385,153	1,546,000 ²
Maroochy	Total	55,873,000	23,198,000	44,000 ²⁹	32,631,000	9,704,000	12,200,00
Noosa	Water	6,658,900	2,544,200	1,786,695	2,328,005	-	450,00
	Sewerage	6,897,000	4,035,800	2,055,955	805,245	1,467,000	55,00
	Total	13,555,900	6,580,000	3,842,650	3,133,250	1,467,000	505,00
Pine Rivers	Water	16,534,000	10,032,000	2,313,000	4,189,000	915,233	172,00
	Sewerage	19,485,000	8,385,000	2,884,000	8,216,000	2,675,769	223,00
	Total	36,019,000	18,417,000	5,197,000	12,405,000	3,591,002	395,00
Redlands	Water	18,297,769	6,404,453	3,249,726	8,643,590	2,112,443	414,56
	Sewerage	20,022,554	6,866,003	2,826,362	10,330,189	2,160,156	206,05

27 Unaudited 1998-99 financial results. Logan reports separately for water and sewerage (not shown).

28 Estimated tax equivalents

29 Water supply and sewerage assets transferred to the Maroochy Water on 30.6.99. The 1999/00 financial year will include a full depr

Council		Total Revenue	OMA	Dep'n	EBIT	Interest	TERs²²
	Total	38,320,323	13,270,456	6,076,088	18,973,779	4,272,599	620,61
Rockhampton	Total	19,881,766	7,597,107	4,055,034	8,229,625	249,454	3,158,03
Thuringowa	Water	9,133,871	4,439,186	1,493,465	3,201,220	-	607,15
	Sewerage	5,726,330	2,252,805	1,713,891	1,759,637	-	525,38
	Total	14,860,201	6,691,991	3,207,356	4,960,857	-	1,132,54
Toowoomba³⁰	Water	18,292,000	6,341,000	2,238,000	9,713,000	2,152,000	
	Sewerage	9,948,000	5,041,000	836,000	4,071,000	1,110,000	
	Total	28,240,000	11,382,000	3,074,000	13,784,000	3,262,000	
Townsville	Total	47,069,654 ³¹	23,519,778	7,010,183	16,539,693	765,631	5,105,19

30 Full cost pricing being phased in over a five year time horizon.

31 Includes contributed assets of \$2.28 million.

Attachment 2: Cost Recovery for Councils with Greater than 5000 Connections ³²

Council		Total Revenue	Operating Costs	Depreciation	Finance Costs	Other Expenses	less Capital exp
Redcliffe	Water	5,807,525	3,112,375	1,327,135			
	Sewerage	4,652,910	1,738,997	1,720,319			
	Total	\$10,460,435	4,851,372	3,047,454			
Bundaberg	Water	5,321,947	2,937,194	120,776	532,880		
	Sewerage	5,496,046	2,788,343	93,301	734,199		
	Total	\$10,817,993	5,725,537	214,077	1,267,079		
Gladstone	Water	6,425,000	4,297,000	635,000	256,000	939,000	
	Sewerage	3,755,000	2,150,000	760,000	699,000	3,000	
	Total	\$10,180,000	6,447,000	1,395,000	955,000	942,000	
Maryborough	Water	4,142,534	2,055,780	360,905	327,700		
	Sewerage	2,075,459	1,094,298	133,104	147,529		
	Total	\$6,217,993	3,150,078	494,009	475,229		
Cooloola	Water	3,606,251	1,614,967	98,367	111,647		
	Sewerage	2,836,710	1,026,696	48,345	42,287		
	Total	\$6,442,961	2,641,663	146,712	153,934		
Johnstone	Water	2,275,000	1,385,000	74,000	280,000		
	Sewerage	1,515,000	795,000		204,000		
	Total	\$3,790,000	2,180,000	74,000	484,000		
Mount Isa	Water	3,532,000	2,672,000	501,000	142,000		
	Sewerage	1,591,000	1,094,000	542,000			
	Total	\$5,123,000	3,766,000	1,043,000	142,000		
Warwick	Water	1,440,167	1,383,070	17,050	14,182	-15,213	
	Sewerage	1,624,993	627,753	26,334	139,143	3,291	
	Total	\$3,065,160	2,010,823	43,384	153,325	-11,922	

³² Other than the *Big 17* Councils.

³³ Variations in capitalised expenditure for individual local governments will depend on the timing of capital expenditure by individual

Council		Total Revenue	Operating Costs	Depreciation	Finance Costs	Other Expenses	less Capital exp
Livingstone	Total	\$8,553,000					
Burdekin	Water	2,098,702	1,384,314	3,234	71,916		
	Sewerage	3,143,867	1,457,140		175,066		
	Total	\$5,242,569	2,841,454	3,234	246,982		
Beaudesert	Water	5,180,988	2,553,917	739,080	254,544		.
	Sewerage	1,654,236	881,685	190,705	244,456		.
	Total	\$6,835,224	3,435,602	929,785	499,000		.

Attachment 3: Big 17 Water and Sewerage Business Activities Two-Part Tariffs; 1999-2000

Council	Category	Tariff	Tariff Details	
			Annual Access Charge	Cost
Brisbane ³⁴	domestic	two-part tariff	\$100	\$0.
	com/ind:	two-part tariff	\$330 - \$74,160 (diameter)	\$0.
	com/ind	valuation	\$0.87 - \$1.30	\$0.
Caboolture ³⁵	domestic	two-part tariff	\$150	\$11
	com/ind	two-part tariff	\$150	\$0.
	commercial metered/ comm./ind. unmetered	two-part tariff unit based	\$100 \$14.88/unit (1 - 170 units)	\$0. N/A
Cairns	domestic	two-part tariff	\$116	\$0.
	com/ind	two-part tariff	\$116	\$0.
	unmetered	two-part tariff	\$116	\$15
	domestic/com/ind			
Caloundra	domestic	two-part tariff	\$80	\$0.
	com/ind	two-part tariff	\$80	\$0.
Gold Coast ³⁶	domestic	fixed charge/excess	\$259 (for 290kL)	<25

³⁴ Brisbane Water introduced two part tariffs for domestic customers and some non-domestic customers in July 1997. On 20 April 1999 metering of all non-domestic properties at the earliest opportunity. In the case of Community Title Scheme properties, metering at first with a phased approach.

³⁵ Domestic residences eligible for water charge refund if full allowance not used within the year.

³⁶ Implementation program for full adoption for two part tariffs by Gold Coast City Council:
 1998-99 – reduce current allowance to 300kL;
 1999-00 – further adjust downwards the allowance;
 2000-01 – introduce a two part tariff consisting of a two tiered volumetric charge;
 2001-02 – further adjust the two part tariff;
 2002-03 – introduce a two part tariff with one volumetric price.

Council	Category	Tariff	Tariff Details	
			Annual Access Charge	Co
	com/ind	fixed charge/excess	\$264 (for 290kL)	<2?
Hervey Bay	domestic	two-part tariff	\$160	\$0.
	com/ind	two-part tariff	\$160	\$0.
Ipswich	domestic	two-part tariff	\$143	\$0.
				\$0.
Logan	Metered – domestic	two-part tariff	\$135	\$0.
	metered – com/ind	two-part tariff	\$200 - \$45,000 (diameter)	\$0.
Mackay ³⁷	unmetered – CTS	fixed charge/excess	\$275 (200 kL)	\$0.
	domestic	two-part tariff	\$235 (300 kL)	\$0.
Maroochy	com/ind	two-part tariff	\$144/factor (charge varies with business type)	\$0.
				\$0.
Noosa	domestic	two-part tariff	\$151.40	\$0.
	com/ind	two-part tariff	\$387 - \$30,280 (diameter)	\$0.
Pine Rivers	domestic	two-part tariff	\$125	\$0.
	com/ind	two-part tariff	\$125 - \$12,500	\$0.
Redland	domestic	fixed charge	\$263 (15mm); \$342 (20-25mm)	No
	com/ind	fixed charge	\$224 to \$1670 (annual)	\$0.
	com/ind	two-part tariff	\$290 - \$3,400	\$0.
Redland	domestic	two-part tariff	\$178.00	\$0.
				\$0.

³⁷ Mackay City Council has indicated it will remove the 300kL base allowance from 1 July 2000.

Council	Category	Tariff	Tariff Details	
			Annual Access Charge	Co
	com/ind	two-part tariff	\$290 - \$3,470	\$0. \$0.
Rockhampton	domestic com/ind	fixed charge fixed charge	\$418.38 unit based	No
Thuringowa	domestic com/ind	unit/excess unit or consumption	\$392.40 (768kL) various unit-based/charges per kL	\$0. \$1.
Toowoomba	domestic com/ind	two-part tariff two-part tariff	\$262 \$262 to \$14672 (diameter)	\$0. \$1. \$0. \$1.
Townsville	domestic com/ind large commercial	fixed charge/excess two-part tariff volumetric	\$346.88 (776kL) \$381.54	\$1. \$1. \$1. \$0.

Attachment 4: Councils with Greater than 5000 Connections³⁸ Two-Part Tariffs; 1998-1999

Council	Two-part tariff report	Category	Tariff	Tariff Details		
	Council Decision			Annual Charge	Access	Consumption
Beaudesert		domestic	unit/excess			\$420 for
		com/ind	unit/excess			various \$1.05/kL
Beaudesert 99/2000	Yes	domestic	unit/excess			2 schen excess 7
	Council to implement	com/ind	unit/excess			2 scher excess 7
Bundaberg		domestic	fixed charge based on valuation/ excess			\$227 for
		com/ind	fixed charge based on valuation/ excess			\$227 fo
Bundaberg	Yes	domestic	fixed charge based on valuation/ excess			\$350 for
	Council yet to decide	com/ind	fixed charge based on valuation/ excess			\$350 for
Burdekin		domestic	fixed charge/excess			\$295 for 2040kL 85c/kL :
		com/ind	fixed charge/excess			\$295 for 2040kL 85c/kL :
Burdekin 99/2000	Yes	domestic	fixed charge/excess			\$300 for 70c/kL : 85c/kL :

³⁸ Other than the *Big 17* Councils.

Council	Two-part tariff report	Category	Tariff	Tariff Details		
	Council Decision			Annual Charge	Access	Consumption
	Council yet to decide	com/ind	fixed charge/excess			\$300 for 70c/kL ; 85c/kL ;
Cooloola		domestic	unit/excess			Various excess \$
		com/ind	unit/excess			various from 25
Cooloola 99/2000	Yes	domestic	unit/excess			various 725kL;
	Council yet to decide	com/ind	unit/excess			various 750kL;
Gladstone		domestic	fixed charge/excess			\$296 for
		com/ind	fixed charge/excess			\$296 for
Gladstone	Yes	domestic	fixed charge/excess			\$296 for
	In principle, Council not to adopt until after 1999-2000	com/ind	fixed charge/excess			\$296 for
Johnstone		domestic	Unit			\$250 for
		com/ind	unit			from \$1
Johnstone 99/2000	No	domestic	unit			\$250 for
	Reviewing charges as part of annual budget process	com/ind	unit			from \$ 70c/kL
Livingstone		domestic	fixed charge/excess			Various (no vc (allowar 390kL).
		com/ind	fixed charge/excess			from \$9 units.

Council	Two-part tariff report	Category	Tariff	Tariff Details	
	Council Decision			Annual Charge	Access
Livingstone 99/2000	Commenced	domestic	fixed charge/excess		Various volumet (allowar 390kL).
	N/A	com/ind			from \$9 units.
Maryborough		domestic	unit/excess		\$238.80 70c/kL
		com/ind	unit/excess		from \$ 600kL);
Maryborough 99/2000	Commenced	domestic	unit/excess		\$322.79 73c/kL
	N/A	com/ind	unit excess		from \$4 excess 4
Mount Isa		domestic	unit/excess		\$410 for
		Com/ind	unit/excess		\$410 - \$ excess 4
Mount Isa 99/2000	No	domestic	unit/excess		\$420 for
		Com/ind	unit/excess		\$420 - excess 4
Redcliffe		domestic	unit/excess		\$206.93
		Com/ind	unit/excess		from \$2 excess 7
Redcliffe 99/2000	No	domestic	unit/excess		\$206.93
		Com/ind	unit/excess		from \$2 excess 7
Warwick		domestic	two-part tariff	\$189	42c to 3
		Com/ind	two-part tariff	\$189/20mm; \$294/25mm; \$424/30mm; \$499/40mm or larger	42c fr \$1.15/kl

Council	Two-part tariff report	Category	Tariff	Tariff Details		
	Council Decision			Annual Charge	Access	Consumption
Warwick 99/2000	Yes	domestic	two-part tariff	\$198		43c to 3
	Council already has a two-part tariff	Com/ind	two-part tariff	\$198/20mm; \$308/35mm; \$444.40/30mm; \$550/40mm or larger		43c fro thereaft

Attachment 5: Big 17 Local Governments – Community Service Obligation Payments – 1998-1999

Local Government	Value	CSOs Provided
Brisbane	\$8 568 000	Pensioner concessions, clearing of combined house drains, other
Caboolture	\$11 154 903	Price path subsidy (CSO provides for tax equivalent and dividend payments).
Cairns	\$1 381 238	Water:- maintenance of fire hydrants, community group concessions, metered consumption; Wastewater:- Council use and Council property concession; community group concessions
Caloundra	\$257 000	Water:- Fire hydrants, beach showers, parks Wastewater:- maintenance of private pump stations, subsidised holding tank collection
Gold Coast	\$5 524 000	Pensioner concessions
Hervey Bay	\$38 786	Concessions to community groups
Ipswich	\$68 060	Water for fire fighting, elimination of combined house drains, sewerage extension to community groups.
Logan	\$88,700	Combined subsidy on water and sewerage charges to sporting bodies
Mackay	\$1 706 000	Rebates to community groups, revenue subsidy for tax equivalents
Maroochy	\$4 606 000	Pensioner concessions and discounts, fire hydrants and fire fighting, WaterWise, support information, superannuation costs imposed by Local Government.
Noosa	\$1 100 000	Pensioner concessions, concessions to community and sporting organisations.
Pine Rivers	\$701 355	Pensioner remissions, community group concessions
Redland	\$38 870	Community/sporting group concessions, non-economic water main extensions
Rockhampton	\$509 039	Water:- pensioner discounts, operation and maintenance of fish ladder; WaterWise associations; water usage on sporting fields. Wastewater:- pensioner discounts, combined line charges, house line blockages.
Thuringowa	\$113 500	Water to Council parks, sporting groups, fire hydrants
Toowoomba	\$0	Not applicable
Townsville	\$680 248	Concessions to sporting and charitable organisations

Attachment 6: Rural Schemes

Bedford Weir stage II

T2 assessment:

The apparent failure to figure cost recovery into the economic assessment of Bedford Weir Stage II is, in the Council's view, a fundamental flaw in the analysis of the economic viability of this scheme. Such a project could not be said to be recovering costs consistent with reform commitments to achieve full cost recovery. The Council's view is that this approach to economic assessment is not consistent with framework commitments.

Further the ecological sustainability assessment was conducted by the water service provider (that is, before the commercialisation of SWP) and that this reflects on the independence of the ecological analysis.

Additional information provided:

Additional information provided by Queensland³⁹ noted the following relevant matters:

- The impact assessment statement (IAS) was conducted by the Rural and Resource Development Group of Queensland Department of Primary Industries and approved by the Department of Environment (30/4/96) and Commonwealth Environment Protection Agency (EPA) (8/5/96).
- The economic analysis indicated that the project was economically viable;
- The capital cost of the project was \$4.73 million. The Commonwealth contributed \$2 million. An auction of water resource allocations realised \$11.1 million. On this basis cost recovery was clearly evident.

Assessment

Ecological Sustainability

Project approval by the Department of Environment and Commonwealth EPA addresses the concerns of the Council in part.

A significant issue with the IAS is that it proceeds on the basis that the Fitzroy Basin WAMP will be completed by November 1996; that plan is not complete as at November 1999. The Council will need to review this project when the Fitzroy WAMP is finalised to ensure compliance with available water allocations

³⁹ Letter of 14 September 1999

Economic Viability

One of the difficulties in assessing the economic evaluation of this project is that the information provided is very brief. The calculations in the evaluation are not reported transparently (for example, by way of a spreadsheet).

That said, it remains the Council's view that the economic assessment failed to include the full cost of water. For example, at page 44 the IAS notes that '*Current water charges are assumed to cover all OM&A costs*'. However, costs should recover to the agreed lower band of pricing. The floor price includes provision for future asset refurbishment or replacement. The floor price also includes externalities, taxes or TERs and the interest costs on debt.

Another example of the deficiencies in the assessment is that the assessment does not factor in the sale of water to a mine when this is identified as a major user of the water.

However, the additional information that \$11 million was recovered from water sales means that despite the apparent shortcomings in the economic analysis, the scheme has proved to be economically viable.

Bingegang Weir stage II

T2 assessment:

No information was received concerning this project for the purposes of the second tranche assessment.

Additional information provided:

The IAS was provided. This has been conducted by the Regional Infrastructure Development Group of DNR.

A significant issue with the IAS is that it proceeds on the basis that the draft Fitzroy Basin WAMP will be completed in June 1997; that plan is not complete as at November 1999.

The IAS notes (at page 34) that sufficient environmental flows will be provided from Bingegang Weir even though construction of Stage II may commence before flows are known:

*‘The expected timing for a decision on the selling of water from the weir augmentation is **after**⁴⁰ the establishment of environmental flow allocations in the Fitzroy system. This is based on the timing of the draft WAMP which is due to be completed in June 1997’.*

A letter from the Department of Environment to DNR concerning the Weir and dated 26 March 1997 provided advice regarding the project (provided to the Council on 1 December 1999). The letter concludes that:

‘Your intentions to seek Executive Council approval to progress the weir are therefore supported conditional on your commitment to allocate water in accordance with the WAMP or interim environmental flow requirements; and to implement the approved [environmental management] Plan for the project’.

The IAS indicates that the cost of the project is \$4.35 million. The study concludes that the project is clearly viable.

Additional information provided by Queensland⁴¹ noted that it is anticipated that water prices at auction will reach the same levels as Bedford Weir Stage II and therefore economic viability should not be an issue. The information also notes that the capital costs for the project are: the Weir, which has been completed except for clean up works (cost \$3.6m); the cost has been paid by the State, but should be recouped through sale of allocation; Bingegang and Bedford Weirs should be

⁴⁰ Their emphasis

⁴¹ Letter of 14 September 1999

considered as a single project; outstanding issues in land resumption and the effect on farmers.

Assessment:

Ecological Sustainability

Project approval by the Department of Environment addresses in part the concern of the Council that the resource manager in DNR did not complete the environmental assessment.

A significant issue with the IAS is that it proceeds on the basis that the Fitzroy Basin WAMP will be completed by June 1997; that plan is not complete as at November 1999. The Council will need to review this project when the Fitzroy WAMP is finalised to ensure compliance with available water allocations

Economic Viability

One of the difficulties in assessing the economic evaluation of this project is that the information provided is very brief. The calculations in the evaluation are not reported transparently (for example, by way of a spreadsheet).

That said, it remains the Council's view that the economic assessment failed to include the full cost of water. For example, the Economic Evaluation notes (at point 3.2) that '*Current water charges are assumed to cover local OM&A costs. These costs have a fixed and variable component*'. However, costs should recover to the agreed lower band of pricing. The floor price includes provision for future asset refurbishment or replacement. The floor price also includes externalities, taxes or TERs and the interest costs on debt.

Another example of the deficiencies in the assessment is that the assessment does not appear to factor in land resumption costs and yet this matter is identified by Queensland as outstanding at present.

Given the advice that Queensland anticipates that water prices at auction will reach the same levels as Bedford Weir Stage II and therefore economic viability should not be an issue, the Council will need to review this project prior to the third tranche assessment to assess the economic viability of the scheme as demonstrated by moneys received from sale of water and ongoing water prices.

Dumbleton Weir Stage III

T2 assessment:

It was unclear whether the IAS, completed in July 1996, included as a cost the recovery of capital costs. The apparent failure to figure in cost recovery was a fundamental flaw in the assessment of economic viability.

The ecological analyses were conducted by the water service provider and this reflects on the independence of the analyses.

Additional information provided:

Additional information provided by Queensland⁴² noted that:

- The project study was undertaken by the Regional Infrastructure Development group in DNR and signed off by the Department of Environment and Resource Management Group (RMG) within DNR. The project is being managed by the Pioneer Valley Water Board (PVWB) which is effectively owned by local cane-growers and is unconnected with SWP.
- Water prices were based on cost recovery of the industry component of project costs (\$1.04m of \$3m).
- PVWB will allocate water to irrigators on the basis that irrigators will pay the capital costs through an annual charge.

Assessment:

Environmental analysis

Project approval by the Department of Environment and RMG and forward commitments made by Queensland⁴³ address the concerns of the Council.

Economic viability

One of the difficulties in assessing the economic evaluation of this project is that the information provided is very brief. The calculations in the evaluation are not reported transparently (for example, by way of a spreadsheet).

It remains unclear whether the economic analysis factors in the true (and not subsidised) cost of water. The three page assessment provides information about water charges to users, but these charges appear to be based on the assumption that water users will not pay for the cost of providing the infrastructure, and instead this will be paid by government. In addition, costs should recover to the agreed lower band of pricing. The floor price includes provision for future asset refurbishment or

⁴² Letter of 14 September 1999

⁴³ The *key deliverables*

replacement. The floor price also includes externalities, taxes or tax equivalent regimes (TERs) and the interest costs on debt.

However, the additional information that PVWB will allocate water on the basis that irrigators will pay the capital costs in the annual charge should ensure that, despite the apparent failure to include cost recovery in the price paid for water in the economic analysis, the scheme will be economically viable.

The Council will need to review this project prior to the third tranche assessment to assess the economic viability of the scheme as demonstrated by moneys received from sale of water and ongoing water prices.

Mareeba-Dimbulah Irrigation Area augmentation of supply

T2 assessment:

No information was received concerning this project for the purposes of the second tranche assessment.

Additional information provided:

The Council was provided with a document *Augmentation of Water Supply, Mareeba-Dimbulah Irrigation Area*⁴⁴. That document outlines that the Mareeba-Dimbulah Irrigation Area (MDIA) augmentation of supply is designed to provide additional water for increased sugar production. It is a two stage process:

- Stage 1 (cost \$8.8m), through which additional water is to be supplied by a new water management system (for example, remote monitoring and control of channel flows, scheduled ordering and supply of water to individual farms), permitting permanent trades in water (since July 1999), increasing pipeline and channel capacity and more effective water harvesting of surplus water flows on Walsh River.
- Stage 2 (cost \$10.5m) provides for additional storages, originally proposed through raising Tinaroo Falls Dam and constructing a new weir on the Barron River.

Stage 1, which has now been completed, was assessed to be strongly viable. The project was assessed as having a net present value of almost \$7m and a benefit/cost ratio of 1.86. The cost-benefit analysis indicates that no government CSO was factored into calculations.

Additional water provided from Stage 1 was sold at an average of \$224-227/ML, which is above the \$200/ML estimated to be required to recover capital works for Stages 1 and 2. In addition, an annual capital charge of \$10/ML/yr over 25 years (in addition to operation, maintenance and refurbishment charges) will be charged, and present water prices are sufficient to recover this.

Additional information provided by Queensland⁴⁵ noted that delivery costs for new water will be priced at the lower bound as part of the pricing reform agenda for MDIA.

In respect of Stage 2:

- alternatives to the Tinaroo Dam proposal are being considered after an adverse assessment of the proposed installation by DNR's dam safety section;
- an off-stream storage (as opposed to a weir) at Bilwon is now preferred to a Weir in the Barron River; and

⁴⁴ unreferenced and undated

⁴⁵ Letter of 14 September 1999

- evaluation of the off-stream storage and the raising of Tinaroo Dam have been delayed pending the finalisation of the Barron River WAMP.

Assessment

On the basis of the information provided, the Council is satisfied that Stage 1 of the MDIA augmentation of water supply has proceeded in a manner consistent with reform commitments. In particular, the information suggests that it is economically viable.

It is noted that the project focussed on improved efficiency through water management and not increasing abstractions of water through development of new rural schemes such as weirs or off-stream storages.

Given that Stage 2 has not proceeded, the Council is not required to assess this project as part of the supplementary assessment. Should the project proceed, the Council will review the relevant IAS to consider analyses of economic viability and ecological sustainability. The Council is encouraged by the decision to await final approval of the additional storages until finalisation the WAMP and sees this action as consistent with the Water Resources Policy.

Moura off-stream storage

T2 assessment:

The Moura off-stream storage raises concerns primarily because the environmental assessment was carried out by the provider of the service. This is not consistent with a requirement for independent appraisal. The Council is concerned that SWP, a commercialised service provider, has a serious conflict of interests in carrying out such an assessment of a resource from which it will then reap financial benefits.

Additional information provided:

Additional information provided by Queensland⁴⁶ noted that:

- Queensland supports the Council's view that a service provider with a financial interest in an infrastructure project should not, at least without independent scrutiny or eventual approval by an environmental agency, undertake the environmental assessment of a project.
- The environmental impacts were considered and endorsed by the RMG within DNR.
- The off-stream storage was chosen after examination of two weirs as it was preferable from an environmental perspective. The storage is essentially a substantial farm dam on a depression adjacent to the river.
- SWP sought approval from RMG, which considered both water availability and site impact. RMG '*recognised that the off-stream storage development was below a threshold for environmental assessment, and recommended that the project be approved by Government*'.
- SWP undertook the assessment as a matter of good practice and not due to there being any formal requirement for an assessment.

Assessment:

Project approval by RMG and forward commitments made by Queensland⁴⁷ address the concerns of the Council.

⁴⁶ Letter of 14 September 1999

⁴⁷ The *key deliverables*

Walla Weir

T2 assessment:

Queensland information:

The IAS (April 1995) conducted by consultants on the basis of information provided by DNR, found potential impacts on flora and developed an environmental management plan. It was noted that:

'While the proposed weir will have some impacts on the environment, these are seen to be acceptable, and recommended measures will limit the overall impact. The Department of Primary Industries is committed to implementation of measures to minimise the environmental impact of the weir and if these are implemented, it is concluded that there are no environmental constraints preventing construction of the weir'.(p4)

The Benefit Cost Analysis (August 1993) indicated positive benefits for the scheme. Cost recovery for the scheme does not appear to have been figured into the cost-benefit analysis. The second tranche report indicates that Walla Weir was one of twelve projects funded under the Sugar Industry Infrastructure Package (SIIP). The project cost was \$14 million.

The second tranche report notes that an allowance for environmental flows has been made in anticipation of the Burnett WAMP.

Assessment

The apparent failure to figure cost recovery in to the economic assessment of Walla Weir is, in the Council's view, a fundamental flaw in the analysis of the economic viability of this scheme. Such a project could not be said to be recovering costs consistent with reform commitments to achieve full cost recovery. The Council's view is that this approach to economic assessment is not consistent with framework commitments.

Additional information provided:

The Council was provided with the Sugar Industry Infrastructure Package (SIIP) Project Proposal *Weir on the Burnett River (Walla Weir)*⁴⁸ completed by affected canegrowers and mill owners.

In addition the Council was provided with an extract from the *Report of the Project Review Panel for the Queensland Sugar Industry Infrastructure Package*. This noted the selection of Walla Weir for SIIP funding in the amount of \$9.49 million with industry and other sources contributing \$4.76 million. The SIIP was a package of measures designed to '*address the changes and challenges confronting the raw sugar*

⁴⁸ September 1993

industry [and] developed jointly by the sugar industry and the Queensland and Commonwealth Governments' One component of the package is the provision for expenditure on infrastructure support, the Queensland Government matching dollar-for-dollar the Commonwealth Government's commitment of \$19 million.

Queensland advised that the funding agreement for the Weir and other SIIP projects was agreed between the Commonwealth and Queensland on 26 November 1993.

The funding of the scheme is as follows:

- \$9.49 million from the SIIP;
- \$3.56 million from irrigators, to be funded by a yet to be established Water Board;
- \$1.2 million estimated from the proceeds of sale of 1200 ML of water; and
- Additional costs met by Queensland Government for additional environmental studies and additional cost due to inflationary impacts on original costs (SIIP funds were not indexed and set in 1993 dollars).

The information notes:

'With regard to the use of full cost reflective prices in the CBA, it is noted that the price of water was generally that which applied within the region at that time. However, all water from the project will be priced at the SCARM lower bound as part of the Government's pricing reforms within the industry ...

Overall, selection criteria two under the SIIP was that "projects must be economically viable such that the discounted direct economic benefits over the projects lifetime must exceed its discounted direct economic costs" The economic assessment of the project was considered by a panel with representation from both the Queensland and Commonwealth Governments and was evaluated as being consistent with this criteria. Additionally, water prices will be at the SCARM lower bound pursuant to price reforms to the Bundaberg Irrigation Scheme'.

Assessment:

The cost-benefit analysis values farm costs as including the cost of irrigation: *the marginal cost of irrigation was taken to be \$22:50 per megalitre and was derived by averaging the marginal costs of flood irrigation and travelling irrigation. At a regional level, water charges represent a transfer of income between users and the state'.*

Water resources costs include the capital costs and operating costs.

The analysis compares two scenarios (that is, (A) to replace current water supplied from upstream and (B) to meet the shortfall on existing entitlements and additional allocations to irrigators whose current entitlements are insufficient to meet needs). The analysis proceeds on the basis that capital costs will not be recovered. The analysis also does not figure in a rate of return on the capital invested. Water is therefore costed in the analysis at below its full cost.

It is for this reason that the Council was of the view that the benefit cost analysis was fundamentally flawed, and not consistent with reform commitments. The Council remains of this view.

Matters of note include that although the project was finally approved in November 1996, it received preliminary (including funding) approval in November 1993, prior to both the COAG water resources policy (2/94) and the Competition Policy Agreements (4/95).

Consistently with the Council's assessment of the Temburra Creek Project, it does not consider that the failure to this scheme to meet the reform commitment that rural schemes be economically viable should result in a reduction in NCP payments to Queensland. This is because funding approval predated both the water resources policy and CPA commitments.

The Council notes the positive statement of Queensland that water prices will reflect the agreed floor price. The Council will assess cost recovery for this and other schemes prior to third tranche assessment.

Warrill Creek Junction Weir

T2 assessment:

No information was received concerning this project for the purposes of the second tranche assessment.

Additional information provided:

The impact assessment scoping study (IASS) was provided to the Council. This has been conducted by Rust PPK Environment and Infrastructure on behalf of the Department of Natural Resources. The objective of an IASS is to produce a report which allows the Queensland Government to determine whether it is environmentally acceptable to construct and operate the new weir.

Additional information provided by Queensland⁴⁹ noted that the weir is designed to improve the operational efficiency of the Warrill Valley Irrigation Area rather than provide for new water allocations.

The IASS:

The proposed Warrill Creek Junction Weir is located in the Bremer River catchment, about 50 km from Ipswich. Its proposed capacity is 400-600ML. The cost of construction of the weir is \$800 000.

The IASS was carried out independently by consultants. The report notes that relevant stakeholders (for example, landholders, river management trusts) were consulted during the review. The report also noted that no new water allocations will be made and the system is to improve reliability.

The economic assessment examines the benefits which would arise from the increased reliability of water supply across a representative sample of crops. The costs included in the analysis are the capital costs although *operation costs of maintaining such a weir would be minimal and as such have been excluded from the analysis*. The assessment concluded that the weir *would have economic benefits in the form of increased agricultural returns from more reliable irrigation water*.

The general conclusion of the IASS was that *no significant detrimental environmental impacts resulting from the proposed weir have been found during this study*.

Assessment

Warrill Creek Junction Weir is a small weir; it has limited capacity; the capital costs are less than \$1 million.

The IASS was carried out independently, included stakeholder consultation and assessed both environmental and economic impacts. The cost/benefit analysis

⁴⁹ Letter of 14 September 1999

considered relevant costs including capital costs. Compared to other assessments the analysis was relatively transparent and included relevant spreadsheets.

The Council is satisfied that the weir has proceeded in a manner consistent with the COAG water resources policy.

Attachment 7: Proposed Institutional Arrangements

WATER REFORM: SOUTH AUSTRALIA

REFORM COMMITMENT: COST REFORM AND PRICING

Commercial water pricing

Outstanding issue, June 1999

As part of their COAG water reform commitments governments have agreed to apply the principles of consumption based pricing and full cost recovery. Governments have also agreed to make cross-subsidies transparent or ideally remove them and for urban water providers to introduce two part tariffs by 1998.

The Council's second tranche assessment stated that South Australia has achieved progress with pricing reform. However, the Council also expressed its concerns over the inclusion of free water allowances and property values in the fixed component of the two part tariff currently paid by commercial water users. However, given a commitment by South Australia to announce its position in relation to this matter by December 1999 the Council agreed to revisit the issue in light of the State's announced position.

Developments since June 1999

South Australia has advised that the Government intends to undertake a consultative process to seek public comment on the future direction of both water (including commercial water) and wastewater pricing. On 8 December 1999 a discussion paper on water pricing was released with written submissions on the issues raised in the paper requested by 15 February 2000. In addition to providing information on current water prices and their origins, the paper also contains information to facilitate public consideration of a wide range of issues including:

- which costs (including environmental costs) should be recovered through prices and how;
- the structure of water prices including the composition of each component of a two part tariff and the appropriateness of other pricing structures such as the current multi-part tariff, negotiated prices for large customers and the use of property values;
- the interpretation and appropriate application in South Australia of COAG water pricing principles;
- the likely distributional implications of pricing reform and how they can be managed; possible changes to the existing customer billing system;
- the most appropriate regulatory arrangements for water pricing with options including:
 - retaining the existing Cabinet based system;

- re-instatement of a Competition Commissioner with responsibilities for making non binding recommendations to Government;
- establishment of a commission with binding powers to set maximum prices, or to set a revenue cap for SA Water within which it could set its own prices, but on a state wide basis; and
- making use of the recently established South Australian Independent Industry Regulator whose immediate role will be in the regulation of the electricity industry.

South Australia has also invited public comment through the Government's on line discussion forum *'Talking Point'*.

The Council understands that once community views have been obtained a Government decision will be made on the future of the State's water prices. The Council also expects that a Government decision on this matter may be achieved by mid 2000.

The South Australian Government also intends to seek community views on current and possible future arrangements for wastewater pricing. To assist this the Council understands that a discussion paper will be released in early 2000 with a Government announcement on future wastewater prices following an appropriate consultation period.

Assessment

Public consultation is an important part of achieving reform consistent with the needs and priorities of the community. There are also merits in consulting across a broad range of water pricing matters simultaneously as it promotes a holistic consideration of the issues. Therefore, while the Council still has concerns regarding the degree to which current commercial water prices are consistent with COAG commitments, it will defer its assessment of this matter until June 2000. However, the Council will seek a Government announcement to implement appropriate water pricing reform at that time. Similarly, (as outlined in the Council's second tranche assessment) the Council will seek a Government decision on future wastewater prices and evidence of progress with bulk water pricing prior to July 2000.

WATER REFORM: TASMANIA

EXECUTIVE SUMMARY

The Council's second tranche assessment expressed concern at the lack of progress made by Tasmania against its commitment to introduce two part tariffs to urban water providers where cost effective by 1998. However, given that external factors such as the State's failed local government amalgamation program had delayed progress and the fact that Tasmania had in place a process to address this issue in a timely way, the Council agreed to reassess progress in December 1998.

The second tranche assessment also noted the Council's concern that current management arrangements for the State's government owned irrigation schemes provided only limited scope for participant involvement in operational management issues. However, given that action was being taken that would result in progress against this reform commitment the Council again agreed to revisit this matter in December 1999.

This report provides:

- a brief summary of the Council's concerns;
- an outline of progress subsequently achieved or planned; and
- a Council assessment in relation progress against second tranche commitments.

Assessment

In regard to the introduction of two part tariffs, Tasmania has made substantial progress over the last six months and has demonstrated a genuine commitment to implementing two part pricing where cost effective as agreed under the COAG framework. However, while Tasmania has now identified an implementation timetable the Council will look for evidence of actual implementation when it conducts a supplementary assessment prior to June 2000 and at its third tranche assessment in 2001.

The State Government has also provided evidence that it is working with irrigation scheme participants to ensure that they have a full understanding of the implications of further devolution of irrigation management and the capacity to initiate change if they so choose. The Council will look for continued progress on this issue in undertaking its third tranche assessment.

REFORM COMMITMENT: COST REFORM AND PRICING

Two part tariffs

Outstanding issue, June 1999

Under the COAG water reform framework all governments have agreed to introduce two part tariffs to their urban water suppliers where cost effective by 1998. The Council's second tranche assessment noted its concern at the lack of progress achieved by Tasmania against this reform commitment.

The Council noted that two part tariffs had been applied in only three of the State's 29 local governments with implementation being considered in a further five.⁵⁰ Further, while Tasmania committed to introduce two part tariffs where cost effective, no indication of when this would occur could be given. Thus the Council had no advice on when a commitment originally due in 1998 would be met.

However, the Council also noted that progress had been delayed by external factors such as the failed local government amalgamation program. In addition, Tasmania had also initiated a process designed to achieve appropriate reform within a reasonable period. Therefore, rather than recommend any suspension or deduction of competition payments the Council agreed to revisit this issue in December 1999 at which time it would look for the Tasmanian Government to provide a reform timetable that would see two part tariffs introduced, where cost effective, as soon as possible.

Developments since June 1999

Process

Prior to the Council finalising its second tranche assessment the Government Prices Oversight Commission (GPOC) released *The Cost Effectiveness of Local Government Council's Implementing Two Part Pricing for Urban Water Services* on 17 June 1999.⁵¹ The GPOC report provided a methodology for assessing the cost effectiveness of introducing two part tariffs.⁵² A letter sent on 2 July 1999 by the Premier (in his capacity as Minister for Local Government) required the application of the GPOC methodology by local governments to the water supply schemes under their control.

An independent review panel then tested the rigor with which local governments applied the methodology outlined in the GPOC report. The Review Panel was comprised of representatives from the Department of Primary Industries, Water & Environment (convenor), Department of Treasury & Finance, Department of Premier

⁵⁰ Urban water supply services are provided by local government in Tasmania.

⁵¹ This report was commissioned by the State's Interdepartmental Water Policy Committee in December 1998. This Committee is made up of representatives from the Departments of Premier & Cabinet, Treasury & Finance and Primary Industries, Water & Environment, and the Office of Local Government.

⁵² The GPOC report also provided a set of principles to ensure that local governments meet the asset renewal and asset maintenance requirements of the agreed water pricing guidelines.

& Cabinet (Policy Division and Office of Local Government) and a nomination by the Local Government Association of Tasmania.

In confirming the validity of the analyses provided by local governments the Review Panel contacted individual local governments as necessary to obtain additional information, amend the modelling work or, where the modelling had shown that a change to two part pricing was likely to be cost-effective, seek a firm date for implementation of the change.

In addition, the Review Panel contacted the State's three bulk water providers to gauge the impact on bulk water prices of customer schemes implementing two part tariffs given that the structure of bulk water prices have a significant impact on the variable costs of these schemes. Tasmania has advised that while the authorities could not provide specific details on the relationship between consumption and variable cost, there was general agreement that a significant reduction in consumption would result in a near-proportional increase in variable costs. This result is due to the high fixed costs of the authorities, in that the authorities' overall costs do not decrease significantly if water use decreases.

Tasmania note that the Review Panel had no authority to require local governments to commit to a firm implementation program for two part pricing where the study showed that such action would be cost-effective. However, to ensure finalisation of this matter, on 6 December 1999, the Premier (in his capacity of Minister for Local Government) wrote to the relevant local governments requesting a firm commitment to the implementation of two part pricing. Local governments complied with this request.

Methodology

In evaluating cost effectiveness Tasmania looked at the extent to which cost savings will be achieved from implementing two part tariffs, relative to local governments existing pricing arrangements. Assessments of cost effectiveness have been undertaken on a scheme by scheme (rather than local government by local government) basis. Tasmania has advised that while local governments are often responsible for a number of water supply schemes they may have no common infrastructure and may draw water from different sources.

The first stage in the methodology provided by the GPOC report was a screening test to establish whether a full-scale test is warranted. The screening test required that:

- only schemes with greater than 1000 connections (which represent around 88 per cent of total connections) were considered;
- where a large scheme is more than 90 percent metered it may be presumed that two part tariffs are cost effective; and
- for small schemes assessments should still be carried out where capacity constraints are identified given the potential savings from curtailing demand.

GPOC stated that a screening test was appropriate given that ‘...a blanket requirement to undertake a full cost effectiveness studies for each scheme would impose an unwarranted cost on councils’.

For those schemes that passed the initial screening test a model was also provided by the GPOC model. This spreadsheet-based model was designed to facilitate a discounted cash flow analysis of up front capital costs as well as on-going costs and benefits. The main costs and benefits identified by the GPOC report are outlined below in Table 1.

Table 1: Main costs and benefits of introducing two part tariffs identified by GPOC

Benefits	Costs
<p>The primary benefits arise from cost savings associated with lower consumption. These include:</p> <ul style="list-style-type: none"> • deferment of increases in capacity for which there would not be demand at cost-reflective prices; • smaller size of new plant; • reductions in variable operating cost, including electricity for pumping, and treatment chemicals and other materials; • reductions in the cost of water purchases, e.g. from bulk supply authorities; • greater control by consumers over the level of their water charges; • overall lower costs; and • more environmentally responsible water use. 	<p>The major cost of implementing a two part tariff is the capital cost of the installation of meters, where these are not already in place. Other costs include:</p> <ul style="list-style-type: none"> • increased meter reading and account processing costs; • tariff evaluation and development; • implementation of accounting systems; and • education and public relations.

Source: Government prices Oversight Commission 1999, *The Cost Effectiveness of Local Government Council's Implementing Two Part Pricing for Urban Water Services*, June.

In response to the variation in the values of some model inputs adopted by local governments the Review Panel determined a ‘standardised’ input or input range. These standardised inputs assisted identifying data supplied by local governments which differed significantly from the data received from the other local governments

or from cost estimates provided by interstate water authorities and consultants (see Table 2).

Table 2: Standardised inputs for various parameters in the GPOC model

Parameter:	Standard:
Timeframe for model	20 years
Discount rate (real)	7%
Maximum cost of installation of new meter (domestic)	\$170
Maximum cost of replacing a meter (domestic)	\$100
Replacement cycle for meters under two part pricing	10 years
Cost of meter reading (per reading)	\$0.70 (urban); \$2.00 (rural)
Maximum number of meter readings per year	4
Minimum reduction in water consumption as a result of two part pricing	15%

Source: Government prices Oversight Commission 1999, *The Cost Effectiveness of Local Government Council's Implementing Two Part Pricing for Urban Water Services*, June.

Tasmania has advised that estimates used for the cost of installation and replacement of water meters for two schemes were well outside the standardised range. Using the estimates provided the model suggested that two part tariffs were not cost effective whereas when the standardised estimates were used a positive result was obtained. However, advice provided by an independent consultant commissioned by the State Government confirmed that using the initial cost estimates was justified.

Results

Tasmania has identified 90 water supply schemes of which cost effectiveness assessments were undertaken for 34. Of the remainder:

- 40 were eliminated by the initial screening process;
- 11 were excluded as a firm commitment was given by the relevant local government to introduce two part pricing prior to any assessment; and
- 5 were already applying two part pricing.

Of those schemes for which a cost effectiveness study was undertaken:

- 26 established that introducing a two part tariff was not cost effective; and
- 8 found that tariff reform was cost effective.

The results of each scheme's assessment are provided as Attachment 1.

Given the above, when fully implemented two part tariffs will apply to 24 schemes in total.⁵³ Where local governments have committed to introduce two part tariffs an implementation date has also been provided (see Table 3).

Of the 19 schemes that have undertaken to implement two part tariffs, six schemes will implement two part pricing commencing in July 2000. The remainder will implement two part pricing commencing in July 2001 with the exception being New Norfolk where two part pricing will commence in July 2004.

Table 3: Implementation Dates for two part pricing

Scheme	Program for implementation of two part pricing
Bracknell	Implementation in 2001-02
Cressy	Implementation in 2000-01
Deloraine	Implementation in 2000-01
Evandale	Implementation in 2000-01
Exton	Implementation in 2001-02
George Town	Implementation in 2001-02
Hadspen	Implementation in 2001-02
Hillwood	Implementation in 2001-02
Kempton	Implementation in 2000-01
Launceston	Implementation in 2001-02
Longford/Perth	Implementation in 2000-01
New Norfolk	Implementation in 2004-05
Prospect Vale	Implementation in 2001-02
Ross	Implementation in 2001-02
Scottsdale	Implementation in 2001-02
Sorell	Implementation in 2000-01
Westbury-Carrick	Implementation in 2001-02
West Tamar	Implementation in 2001-02
Wynard-Somerset	Implementation in 2001-02

Source: Tasmanian Government 1999, *Report on the Cost-Effectiveness of Implementation of Two Part Pricing for Urban Water Supply Services in Tasmania*, December.

⁵³ This figure is made up of the 8 schemes where an evaluation of costs effectiveness suggested that implementation was appropriate, the 11 schemes where a commitment to implement reform was given without a cost effectiveness evaluation and the 5 schemes where two part tariffs already apply.

Assessment

Results of cost effectiveness evaluations

Tasmania has made substantial progress against its urban pricing commitments since the Council undertook its July 1999 assessment. The Council commends the progress achieved by the State and local governments on what has proven to be a challenging area of reform.

The Council notes that the outcome of the assessment process adopted by Tasmania is that, when fully implemented, two part tariffs will apply in only 24 of the State's 90 urban water supply schemes.⁵⁴ This will mean that two part tariffs will be levied on around 42 per cent of total connections.

The Council notes that preliminary screening resulted in 40 schemes being eliminated from further consideration. However, advice provided by Tasmania suggests that these schemes only accounted for 3.4 percent of total connections.

A more significant factor underlying the relatively small proportion of connections which will have two part tariffs applied is that two part tariffs were found to be not cost effective in some of the State's largest water supply schemes. For example, 3 of the State's 4 largest schemes will not be applying a two part tariff. These schemes are Hobart, Clarence and Glenorchy which account for around 32 per cent of total connections.

Tasmania note that these schemes (as well as another large scheme Kingborough where a two part tariff pricing regime was also found to be not cost effective) have a number of common characteristics:

- they are located in or near the centre of the Greater Hobart area;
- the percentage of metered connections is low (5-30 per cent);
- a high capital cost of installing new meters given high level of established infrastructure (for example, roads, old buildings, old pipes);
- the number of connections (and total water consumption) is high relative to other schemes in Greater Hobart (87 per cent of total connections); and
- a significant reduction in water consumption as a result of two part pricing would impact adversely on Hobart Water Authority's revenue requirement (that is, any saving to the council in variable costs would probably be almost negated by a consequent increase in Hobart Water's variable price).

Tasmania also note that the principal reasons behind the negative assessments obtained for these jurisdictions (where net present values varied from -\$301 000 to -\$2.8 million) are:

⁵⁴ This figure includes the 5 schemes already applying two part tariffs and the 19 schemes where a commitment to implement them has been made.

- the high initial capital cost of meter installation;
- minimal savings in variable costs as a result of reduced demand (see above);
- only minor savings in capital costs as a result of any decrease in demand⁵⁵;
- decreasing water use (for example, over the last five years, the total quantity of water supplied by Hobart Water to Greater Hobart councils has steadily declined by 14 per cent); and
- a predicted decline, or at least no growth, in population and hence in water demand⁵⁶.

Finally, Tasmania note that a change to two part tariffs by major local governments in the Hobart region is not necessary to ensure sustainable use of the raw water resources. The majority of Hobart's supply is taken from the Derwent River, one of several rivers in the State where current consumptive usage is well below the sustainable level (Rivers and Water Supply Commission, 1996 internal report).

The Council has reviewed the data and calculations used in the cost effectiveness studies undertaken by Tasmania but has not attempted to redo or second-guess individual results. Rather, the Council has looked to ensure that calculations of cost effectiveness have been derived from a sound assessment process and methodology. Where the Council can be satisfied of this it can also be confident that the results arising from the process are also sound.

It is the Council's view that factors such as:

- the rigour of the assessment framework established by GPOC;
- assistance provided to local governments in applying this framework; and
- the scrutiny applied to each assessment by the Review Panel;

enable it to be confident that the outcomes arising the process adopted by Tasmania are robust. Therefore, the Council suggests that while two part tariffs are to be applied to only a relatively small proportion of the State's water supply schemes this result has been derived through a rigorous process and is therefore consistent with NCP commitments.

⁵⁵ Most capital expenditure on water schemes by councils is in routine replacement of infrastructure. These costs are more sensitive to peak daily demand than total annual demand. Historically, peak daily demand has been readily controlled by the imposition of water restrictions as necessary.

⁵⁶ Over the past two years Tasmania's population has declined by an average annual rate of 0.2 per cent due principally to a sharp increase in interstate out-migration. A further decline in the population is expected in the current year. Recent ABS forecasts have also painted a gloomier scenario by predicting a 20-50% reduction in population for the region over the next 50 years, though this has not been assumed for any demand projections.

Implementing Two Part Tariffs

The Council notes that in three of the five schemes reported by Tasmania to be already applying two part tariffs a free water allowance of 50 kL is also provided. The Council's view is that free water allowances have the potential to result in cross-subsidies and distorted consumption patterns leading to inefficient and unsustainable water use. The Council therefore suggests that to eliminate the potential for these negative outcomes free water allowances should be minimised or ideally removed. Where they are retained the Council would look for evidence that most customers pay volumetric charges and that no cross-subsidies are present. However, as outlined in the Council's July assessment the composition of two part tariffs will be considered further in a June 2000 supplementary assessment.

The reform timetable provided by Tasmania suggests that all but one of the schemes implementing reform will have done so by 2001-02. Tasmania note that the delay in implementing two part tariffs is attributable to the lead time required to implement water meter installation programs and the date upon which the relevant bulk water authority will introduce volumetric pricing.

The timetable provided suggests that Tasmania will be able to confirm that two part pricing will commence for six schemes in June 2000 and for a further 12 schemes in June 2001. The Council will therefore look for advice that the timetable provided by Tasmania is complied with in conducting a supplementary assessment in June 2000 and at its third tranche assessment in June 2001.

The current implementation date listed for the New Norfolk scheme of June 2004-05 is well beyond the date of the Council's third tranche assessment. The Council will seek further advice from Tasmania as to the need for this delay. However, a strong justification would be needed for such a significant delay given the fact that this commitment was originally due by the end of 1998.

In summary, Tasmania has made very substantial progress over the last six months and has demonstrated a genuine commitment to implementing two part pricing where cost effective as agreed under the COAG framework. However, as this commitment is still being implemented the Council will look for progress with actual implementation of appropriately structured two part tariffs when it conducts a supplementary assessment in June 2000 and at its third tranche assessment.

Scope for greater irrigator involvement in managing irrigation schemes

Outstanding issue, June 1999

Tasmania's three Government irrigation schemes, Cressy-Longford, South-East and Winneleah schemes, are currently managed by the Rivers and Water Supply Commission (RWSC). The Council's July 1999 second tranche assessment expressed a view that while irrigators are consulted on significant issues, current arrangements provide only limited scope for irrigator involvement in day to day management issues. However, consultants had been commissioned to explore alternative management structures for the three government owned irrigation schemes. The Council therefore undertook to revisit this issue following the completion of the consultancy reports.

Developments since June 1999

Tasmania has advised the Council that to progress the devolution of irrigation management, Management Committees for each of the three schemes have been established, comprising local irrigators. Consultancy reports on the implications of privatising of these three irrigation schemes have been completed for the Cressy-Longford and Winneleah schemes with the South-East report due in January 2000. The completed consultancy reports suggest that privatisation will result in a cost saving of around \$7.50 per ML for Winneleah and a cost increase of about a \$6.39 per ML for Cressy-Longford.

Business plans for the privatisation of the Cressy-Longford and Winneleah schemes have been completed and public meetings have been held in response to the two completed reports. The State Government has advised that business plans for the South-East scheme will be finalised soon after the consultants' report is completed.

To further assist irrigators in assessing options for devolution of irrigation management, the RWSC flew a representative of each of the three schemes to Western Australia to allow them to observe arrangements adopted in that State.

On 2 December 1999, the Cressy-Longford Management Committee convened a meeting to discuss the future management of the scheme. The meeting passed a resolution that the Management Committee investigate options for self-management of the scheme by users. The Winneleah Management Committee has also informed the RWSC that it wishes to discuss options for self-management.

The Council understands that none of the three schemes have yet secured majority support for a particular devolution model. However, Tasmania has undertaken to develop an implementation timetable with clearly defined end dates once a model for devolution has been agreed for each of the schemes.

Assessment

The Council notes that less than 10 per cent of the irrigation water used in Tasmania is sourced from publicly owned infrastructure. The Council also recognises the progress achieved by Tasmania since July 1999. The measures taken by Tasmania ensure that irrigators are fully cognisant of the costs and benefits of privatisation. Information provided to the Council suggests that Tasmania's commitment to this

issue will continue. For example, the RWSC has offered to meet with irrigator representatives in early 2000 to assist in the development of self-management options and the Government has undertaken to develop an implementation timetable should irrigators choose to take on more management responsibility.

The Council is of the view that significant progress has now been made against the State's commitment to facilitate greater participant involvement in irrigation management. The Council will look for evidence of continued progress on this matter in undertaking its third tranche assessment including evidence that:

- the full spectrum of reform options have been explored;
- a decision has been made for all three schemes on whether devolution is to occur and if so how; and
- an appropriate regulatory framework has been put in place where further devolution is to occur.

Attachment 1: Results of evaluating the cost effectiveness of two part tariffs

Tasmanian Water Supply Schemes - Outcome of Study of Cost effectiveness of Two Part Pricing

Scheme	No. connections	Was a full cost-effectiveness review undertaken?	Result of cost-effectiveness review	Program for implementation of two-part pricing
Break O'Day				
Comwall	48	No: screened out		
Fingal	221	No: screened out		
Mashima	62	No: screened out		
Scamander	368	No: screened out		
St Helens	1569	No: two part pricing in place.		Two-part pricing currently in place
St Marys	335	No: screened out		
Brighton				
Brighton	4845	No: two part pricing in place		Two-part pricing currently in place
Burnie				
Burnie	7936	Yes	Not cost effective. (NPV: -\$107,000)	
Central Coast				
Ulverstone	7189	Yes	Not cost effective. (NPV: -\$236,000)	
Central Highlands				
Bothwell	221	No: screened out		
Ellendale	83	No: screened out		
Gretna	65	No: screened out		
Hamilton	109	No: screened out		
Ouse	100	No: screened out		
Waratah	77	No: screened out		
Westview	45	No: screened out		
Circular Head				
Smithton	1625	No: two part pricing in place (includes 50 kl free allowance)		Two-part pricing currently in place
Stanley	296	No: two part pricing in place (includes 50 kl free allowance)		Two-part pricing currently in place
Clarence				
Clarence	17475	Yes	Not cost effective. (NPV: -\$301,000)	
Derwent Valley				
Boyer	5	No: screened out		
Granton	88	No: screened out		
Magra	245	No: screened out		
Molesworth	58	No: screened out		
National Park	14	No: screened out		
New Norfolk	1882	Yes	Cost effective. (NPV: \$504,000)	Implementation in 2004/5
Devonport				
Devonport	10475	No: two part pricing in place.		Two-part pricing currently in place
Dorset				
Bramholm	146	No: screened out		
Bridport	796	No: screened out		
Derby	86	No: screened out		
Gladstone	60	No: screened out		
Herrick	17	No: screened out		
Legrowood	71	No: screened out		
Pioneer	54	No: screened out		
Rainaugooma	175	No: screened out		

Tasmanian Water Supply Schemes - Outcome of Study of Cost Effectiveness of Two Part Pricing

Scheme	No. connections	Was a full cost-effectiveness review undertaken?	Result of cost-effectiveness review	Program for implementation of two-part pricing
Scottsdale	862	No: Council committed to introduce two-part pricing.		Implementation in 2001/2
Wamatolah	91	No: screened out		
Flinders				
Lady Barron	161	No: screened out		
Whitmark	195	No: screened out		
George Town				
George Town	2082	No: Council committed to introduce two-part pricing.		Implementation in 2001/2
Hillwood	169	No: Council committed to introduce two-part pricing.		Implementation in 2001/2
Glanougan Spring Bay				
Bickeno	772	Yes	Not cost effective (NPV: -\$215,000)	
Coles Bay	257	Yes	Not cost effective (NPV: -\$106,000)	
Orford	869	No: screened out		
Swansea	616	Yes	Not cost effective (NPV: -\$181,000)	
Tahbunna	340	Yes	Not cost effective (NPV: -\$122,000)	
Glenorchy				
Glenorchy	16600	Yes	Not cost effective (NPV: -\$1,182,000)	
Hobart				
Hobart	20468	Yes	Not cost effective (NPV: -\$2,769,000)	
Huon				
Cygnel	807	Yes	Not cost effective (NPV: -\$155,000)	
Dover	613	Yes	Not cost effective (NPV: -\$611,000)	
Greenslon	942	Yes	Not cost effective (NPV: -\$356,000)	
Huonville	1860	Yes	Not cost effective (NPV: -\$325,000)	
Hudbury	75	No: screened out		
Mountain River	42	No: screened out		
Kentish				
Sheffield	835	Yes	Not cost effective (NPV: -\$201,000)	
Kingborough				
Kingston/BB	8600	Yes	Not cost effective (NPV: -\$1,473,000)	
King Island				
Currie	417	Yes		
Grassy	70	No: screened out	Not cost effective (NPV: -\$50,000)	
Lalorbe				
Lalorbe	3002	Yes	Not cost effective (NPV: -\$737,000)	
Lamcesston				
Lamcesston	25500	No: Council committed to introduce two-part pricing.		Implementation in 2001/2
Llyfalye	160	No: screened out		
Meander Valley				
Bracknell	174	No: Council committed to introduce two-part pricing.		Implementation in 2001/2
Dalhousie	1011	No: Council committed to introduce two-part pricing.		Implementation in 2000/1
Exton	866	No: Council committed to introduce two-part pricing.		Implementation in 2001/2

Tasmanian Water Supply Schemes - Outcome of Study of Cost Effectiveness of Two Part Pricing

Scheme	No. connections	Was a full cost-effectiveness review undertaken?	Result of cost-effectiveness review	Program for implementation of two-part pricing
Headspan	603	No: Council committed to introduce two-part pricing		Implementation in 2001/2
Mole Creek	194	No: screened out		
Prospect Vale	1968	No: Council committed to introduce two-part pricing		Implementation in 2001/2
Westbury-Carrick	174	No: Council committed to introduce two-part pricing		Implementation in 2001/2
Northern Midlands				
Avoca	103	No: screened out	Not cost effective. (NPV: -\$74,000)	
Campbell Town	527	Yes	(Independent audit of modelling inputs in progress)	
Conara	36	No: screened out		
Cressy	330	Yes	Cost effective. (NPV: \$23,000)	Implementation program under negotiation - free allowance halved to 200 RL in 1999/2000
Epping	23	No: screened out		
Evandale	882	Yes	Cost effective. (NPV: \$26,000)	Implementation program under negotiation - free allowance halved to 200 RL in 1999/2000
Longford/Perth	2435	Yes	Cost effective. (NPV: \$37,000)	Implementation program under negotiation - free allowance halved to 200 RL in 1999/2000
Ross	200	Yes	Cost effective. (NPV: \$35,000)	Implementation program under negotiation
Rossarden	108	No: screened out		
Sorell				
Sorell	1760	Yes	Cost effective. (NPV: \$64,000)	Implementation in 2000/1
Southern Midlands				
Colerbrook	66	Yes	Not cost effective. (NPV: -\$9,000)	
Kempson-Campina	805	Yes	Cost effective. (NPV: \$22,000)	Implementation in 2000/1
Oatlands	348	Yes	Not cost effective. (NPV: -\$33,000)	
Tunbridge	95	Yes	Not cost effective. (NPV: -\$9,000)	
Tasman		No water schemes.		
Waratah-Wynyard				
Waratah	3694	Yes		
Wynyard-Somersel	111	No: screened out	Cost effective. (NPV: \$3,000)	Implementation in 2001/2
Yalla	79	No: screened out		
West Tamar				
West Tamar	7965	No: Council committed to introduce two-part pricing.		Implementation in 2001/2
West Coast				
Queensdown	1283	Yes	Not cost effective. (NPV: -\$201,000)	
Roadsbury	705	Yes	Not cost effective. (NPV: -\$69,000)	
Sirahan	519	Yes	Not cost effective. (NPV: -\$46,000)	
Tullah	168	Yes	Not cost effective. (NPV: -\$22,000)	
Zeehan	576	Yes	Not cost effective. (NPV: -\$66,000)	
Total:	170478			

Source: Tasmanian Government 1999, *Report on the Cost-Effectiveness of Implementation of Two Part Pricing for Urban Water Supply Services in Tasmania*, December.

WATER REFORM: NORTHERN TERRITORY

EXECUTIVE SUMMARY

The Council's second tranche assessment of Northern Territory progress against NCP water reform commitments identified a number of areas where either second tranche commitments had not been met or where insufficient information had been provided to demonstrate compliance. However, given that the Northern Territory had demonstrated a genuine commitment to meeting all water reform commitments the Council agreed to review both categories of matters as part of a December 1999 supplementary assessment.

Since that time the Northern Territory has made significant progress towards reform outcomes consistent with second tranche commitments and has provided the Council with a substantial amount of additional information. For each outstanding second tranche issue this paper provides:

- a brief summary of the Council's concerns;
- an outline of progress subsequently achieved or planned; and
- a Council assessment in relation progress against second tranche commitments.

Assessment

The Council is now satisfied that second tranche commitments have been met in relation to: full cost recovery, rates of return, cross-subsidies, an implementation program for priority water resources, and processes for assessing the economic viability of new rural investment.

While substantial progress has been made in relation to water allocations and trading and institutional separation the Council will revisit these matters in June 2000 to confirm that appropriate legislation has been passed and that any amendments are consistent with NCP water reform commitments. The Council will also look for further progress on the implementation of internal bulk water charges at this time.

REFORM COMMITMENT: COST REFORM AND PRICING

Cost recovery, rate of return

Outstanding issue, June 1999

As outlined in the Council's assessment framework all governments have agreed to apply the principle of full cost recovery to their water businesses. Governments have also agreed that full cost recovery means setting prices within a range that ensures that the activity earns sufficient revenue to be commercially viable but does not extract monopoly profits. The COAG framework does not prevent governments from providing assistance to achieve social objectives such as lower prices for pensioners. But the cost of achieving these objectives should ideally be met through a community service obligation (CSO). In addition, the framework suggests that any cross-subsidies not consistent with efficient service provision should be made transparent or ideally removed.

A set of pricing guidelines has been agreed to by governments which state that to be commercially viable service providers should earn enough revenue to cover operating, maintenance and administration costs, externalities, taxes or tax equivalent regime payments (TERs) interest costs, provision for asset refurbishment/replacement and commercial dividends (if any). The agreed guidelines also state that to avoid monopoly returns service providers should not recover more than operating, maintenance and administration costs, externalities, taxes or TERs and provision for the cost of asset consumption and the cost of capital.

The Council's July 1999 second tranche assessment concluded that in 1997-98 (the most recent year for which data was available) water and wastewater businesses operated by the Northern Territory Power and Water Authority (PAWA) were operating below the minimum as defined by the agreed pricing guidelines even when CSOs were taken into account. However, the second tranche assessment also noted that action was being taken to address this including:

- a financial improvement target of \$30 million per year to be achieved within three years and substantial changes to CSO arrangements;
- water business revenues were forecast to increase by around 12 per cent in 1998-99 while higher prices were expected to result in total demand falling by 8.5 per cent;
- wastewater revenues were forecast to increase by almost 6 per cent in 1998-99; and
- future price paths would be considered in light of a consultancy report to be completed by September 1999.

Therefore, while the Council did not believe that second tranche commitments had been met, given that action was being taken to improve PAWA cost recovery levels the Council agreed to revisit this matter as part of a December 1999 supplementary assessment.

Developments since June 1999

PAWA's 1999 Annual Report suggests that in total water and sewerage services provided to the Northern Territory's four main urban areas earned sufficient returns to recover all elements of the lower band of the agreed pricing guidelines.

Information provided on each urban area suggests that water supply services to the Darwin region are earning sufficient revenue to be commercially viable as are services to the Katherine and Alice Springs regions once CSOs are taken into account (see Table 1). Water supply services to Tennant Creek appear to be below the lower band of the agreed guidelines. However, consistent with COAG framework requirements, the resulting cross-subsidy has been transparently reported in PAWA's 1999 Annual Report.

Table 1: Water supply cost recovery major and minor urban centres, 1998-99

	Darwin	Katherine	Tennant Creek	Alice Springs	Total
	\$'000	\$'000	\$'000	\$'000	\$'000
Operations, Maintenance, Administration ⁵⁷	12,323	2,373	941	5,561	21,198
Debt Servicing	3,706	476	398	1,229	5,809
Annuity for Asset Replacement	2,387	91	247	451	3,176
Minimum Variable Costs	18,416	2,940	1,586	7,241	30,183
Total Revenue	25,160	2,609	1,027	6,471	35,267
- from Trading (excluding CSO)					
CSO	-	361	331	1,379	2,071
Surplus/Deficit (Excluding CSO)	6,745	-330	- 560	- 770	5,084
Surplus/Deficit (Including CSO)	6,745	30	-229	609	7,155

Source: Power and Water Authority of the Northern Territory 1999, *Annual Report for the Year Ended 30 June 1999*, December.

As with water supply services, in 1998-99 total receipts (including CSOs) for sewerage services to the Northern Territory's main urban areas appear to be within the band of prices provided by the agreed pricing guidelines (see Table 2).

With regard to services provided to individual regions, the Council notes that services to Darwin and Alice Springs and their surrounding areas are earning returns above the agreed minimum. Services to the Katherine and Tennant Creek regions (which have populations of at least 9200 and 3500 people respectively) did not earn sufficient revenue to meet the guideline's definition of a viable service, however, the resulting cross-subsidy has been transparently reported in PAWA's 1999 Annual Report.

⁵⁷ includes TERs and costs of complying with environmental requirements, excludes interest and depreciation

Table 2: Wastewater services cost recovery for major and minor urban centres, 1998-99

	Darwin	Katherine	Tennant Creek	Alice Springs	Total
	\$'000	\$'000	\$'000	\$'000	\$'000
Operations, maintenance, administration ⁵⁸	9,292	897	486	2,151	12,826
Debt servicing	2,094	325	123	696	3,238
Annuity for asset replacement	1,277	144	62	357	1,840
Minimum variable cost	12,663	1,366	671	3,204	17,904
Total Revenue	15,379	1,081	516	4,039	21,015
- from Trading (excluding CSO)					
Surplus/Deficit (Excluding CSO)	2,716	- 285	- 154	835	3,111
Surplus/Deficit (Including CSO)	2,716	- 206	- 99	835	3,245

Source: Power and Water Authority of the Northern Territory 1999, *Annual Report for the Year Ended 30 June 1999*, December.

Assessment

Under COAG water reform commitments governments have committed to the principle of full cost recovery and desirably the removal of cross-subsidies that are not consistent with efficient and effective service provision. However, the agreed reform framework also notes where cross-subsidies remain they should be made transparent.

Given the above, the Council accepts that the Northern Territory has now achieved sufficient progress to meet minimum second tranche cost recovery commitments. However, given performance improvement measures already underway the Council would expect to see evidence of continued progress when it undertakes its third tranche assessment.

⁵⁸ includes TERs and costs of complying with environmental requirements, excludes interest and depreciation.

Bulk water pricing

Outstanding issue, June 1999:

The Council's second tranche assessment framework notes that metropolitan bulk water and wastewater suppliers must establish internal and external charges to include a volumetric component or two-part tariff with an emphasis on the volumetric component to recover costs and earn a positive real rate of return.

In June 1999 the Council did not have sufficient evidence to be satisfied that bulk water and retail activities had been appropriately ring fenced to facilitate internal and external charges. PAWA's 1998 Annual Report stated that financial information would now be prepared on up and downstream components for water and sewerage services but little information on the size or nature of any internal or external charges for bulk water services was provided.

Developments since June 1999

The Council has been advised that as of 1 July 1999 PAWA's ledger has been restructured on product and service lines. The new structure for water and sewerage services is shown below.

Water Services

Headworks

- Treatment
- Reticulation

Sewerage Services

- Collection
- Treatment
- Effluent

Support services (Business Services, Asset Services and Executive Services)

- Support services are cross-charged to the above business lines in accordance with service level agreements.

The Northern Territory has advised that the above ledger structure permits ring fencing of costs as well as pre and post treatment internal bulk water prices. Output provided to the Council using above ledger arrangements demonstrates that substantial progress towards identifying the costs associated with each business unit has been achieved.

However, work to enable automatic allocation of fixed asset costs (a component of the lower band of prices) is not expected to be completed until the end of the year. Available information also suggests that some executive, business, retail and infrastructure service costs remain unallocated or have not yet been cross-charged

although evidence of some progress on this matter has been provided. A moratorium on changes to PAWA's customer billing program until after 1 January 2000 also means that automatic calculation of costs per unit sales cannot yet be introduced although this can currently be done manually.

In respect of external bulk water charges the Council understands that commercial bulk water costs are determined on the basis of bulk water prices pre or post treatment, plus any additional infrastructure or operational costs incurred in the contracted bulk delivery. While there are currently no bulk water deliveries in the Northern Territory the Council understands that indicative contract prices have been submitted to proponents of a number of large industrial projects currently at the feasibility assessment stage.

Assessment

The Council's view is that once fully implemented the new accounting arrangements will provide a basis for better identification of the costs incurred by internal bulk water services thus promoting greater transparency, accountability and efficiency. While the Council accepts that PAWA has the capacity to provide bulk water on a commercial basis the improved accounting arrangements currently being implemented should also assist more timely and robust cost estimates being provided to potential external bulk water customers.

The Council notes the significant progress already achieved by PAWA on this issue and understands that an automatic allocation for capital costs is contracted to be in place by the end of December 1999. However, the Council also notes that a significant amount of support service costs remain unallocated.

While the Council commends the substantial progress achieved by PAWA to date, it is of the view that this reform commitment is still to be met in full. Therefore, Council will review progress on this matter in June 2000. At this time the Council will look for evidence that automatic links to capital costs and the customer billing system have been achieved and that the remaining unallocated costs have been allocated. The Council also suggests that consideration be given to separately funding as a CSO the cost of services to places of worship etc that are currently funded by PAWA as grants and subsidies. The Council will also look for evidence that the internal bulk water charging system is functioning effectively in undertaking its third tranche assessment.

Cross subsidies

Outstanding issue, June 1999

Under the COAG framework all States and Territories have agreed to transparently report cross-subsidies. Jurisdictions have also agreed to the desirability of removing cross-subsidies where they are not consistent with efficient service use or provision. For the purposes of the COAG framework a cross-subsidy exists where a customer pays less than the long run marginal cost and the difference is being paid for by other customers.

The second tranche assessment noted that PAWA is a vertically integrated provider of water, wastewater and energy services to customers throughout the Northern Territory which together with the Government's uniform tariffs policy provides substantial scope for cross-subsidies. The second tranche assessment also noted that measures announced in the 1999-00 Budget Papers will see full CSO funding of the uniform tariff and thus address a potentially significant source of cross-subsidies. However, the Council did not have sufficient information to be satisfied that there was not cross-subsidisation between service segments (for example, from electricity to water activities) or between customer groups.

Developments since June 1999

As to the Council's concerns regarding the existence of cross-subsidies between service segments, the Northern Territory has advised that service segments pay the same price as external customers for services provided by other service segments and thus do not receive any preferential treatment. For example, water services pay the same *Gazetted* tariff as external customers for electricity.

As noted above, the cross-subsidy provided to Katherine sewerage services and Tennant Creek water and sewerage services has been transparently reported in PAWA's 1999 Annual Report.

Assessment

Supplementary information provided by the Northern Territory suggests that the Council can now be satisfied that second tranche commitments in relation to cross-subsidies have been met.

Assessing the economic viability of new rural investment

Outstanding issue, June 1999

The COAG framework states that future investment in new rural schemes or extension to existing schemes be undertaken only after appraisal indicates that it is economically viable and ecologically sustainable. The Council's second tranche assessment looked for policies and procedures to be in place to robustly demonstrate the economic viability and ecological sustainability of new investments in rural schemes.

In conducting its second tranche assessment the Council was satisfied that Northern Territory processes for establishing the ecological sustainability of new investment proposals were consistent with second tranche commitments. The Council was also satisfied that economic viability criteria adopted by PAWA are consistent with second tranche commitments. However, it did not have sufficient information on actual or proposed government involvement in other water infrastructure investment and the economic viability assessment criteria adopted where or if this were to take place.

Developments since June 1999

The Northern Territory has advised that investment in rural water infrastructure is a matter for the private sector and that there is no policy which provides for government assistance to private investment in rural water infrastructure. The Northern Territory also state that this is demonstrated by the fact that all investment in irrigation water infrastructure to date has been entirely funded by the private sector without government assistance.

Assessment

With the clarification of the Northern Territory Government's policy on investment in rural water infrastructure the Council is satisfied that second tranche commitments have been met.

REFORM COMMITMENT: INSTITUTIONAL REFORM

Separating service provision from standard setting and regulation

Outstanding issue, June 1999

In undertaking its second tranche assessment the Council looked for jurisdictions, at a minimum, to separate service provision from regulation, water resource management and standard setting. Under the agreed COAG framework appropriate separation was to be achieved by the end of 1998.

The second tranche assessment noted that the Northern Territory has made progress in separating service provision from environmental management and regulation. However, while the Council was aware that PAWA still retained a number of regulatory functions, no information was provided on the nature or significance of these functions or when they would be transferred. While the Northern Territory advised that separation of these functions was a specific objective of the reform program being applied to PAWA, no definite date was given as to when this would be achieved. Consequently, the Council was not given any indication on when a reform commitment due by the end of 1998 would be realised. Further, the Council had insufficient information to be satisfied that arrangements for setting, monitoring and enforcing health and service standard were consistent with NCP commitments.

Developments since June 1999

The Northern Territory has provided the Council with further information in relation to current and proposed regulatory and standard setting arrangements. This included advice that in November 1998 the Northern Territory Government approved the development of a regime for applying economic regulation to electricity, water and sewerage services. Subsequently, in September 1999, the Northern Territory Government authorised the drafting of legislative amendments to separate PAWA's remaining regulatory functions and establish a regime for economic regulation. The Northern Territory has proposed the below timetable for reviewing current arrangements and implementing the necessary legislative changes.

Table 3: Timetable for addressing remaining second tranche institutional separation issues

Action	Date Due
Close of tenders for engagement of consultant to review relevant legislation	26 November 1999
Completion of review	Late January 2000
Drafting of legislative amendments	February/March 2000
Introduce legislation to Parliament	May 2000
Legislation passed by Parliament	Target June 2000 (August 2000 at latest)

As part of their institutional reform agenda the Northern Territory Government has committed to establishing a Utilities Commission to undertake economic regulation, initially for electricity services.

The Council also understands that from April 2000, the Utilities Commission will licence suppliers, administer a Network Access Code and regulate prices and service standards in the supply of electricity. The Northern Territory has stated that it is focusing initially on electricity services given the greater potential for real competition in this area. However, the Council has been advised that similar arrangements are being considered for water and sewerage services.

In relation to setting, monitoring and enforcing health standards, the Council has been advised that the Chief Health Officer of Territory Health Services is responsible under the Public Health Act for the safety of water supplied by water service utilities and agencies. Water quality samples collected by PAWA are independently analysed by the Northern Territory Department of Primary Industry and Fisheries laboratories on a fee for service basis. Also, the Potable Water Quality Committee, chaired by the Chief Health Officer and including a range of stakeholders, was established in 1993 to address issues of potable water quality (as provided for in the 1996 Australian Drinking Water Guidelines). A review of the Committee is currently being undertaken to ensure its ongoing relevance.

Assessment

Price regulation

Under current arrangements water and sewerage prices are set by Cabinet based on a submission prepared by the Minister for Essential Services (who is the Minister responsible for PAWA) in consultation with Northern Territory Treasury. Dividends are set by the Treasurer. While the Council acknowledges that these arrangements are consistent with minimum second tranche commitments, the Council strongly supports the timely vesting of responsibility for the economic regulation of water and sewerage services with the Utilities Commission. The Council suggests that such a move has the potential to lead to a more independent, transparent and open process for setting water and sewerage charges.

Health Standards

The Council notes that under current arrangements the same Minister has responsibility for both PAWA and health services suggesting a possible conflict of interests. However, given that it is the Chief Health Officer who has the authority under the Public Health Act to require that action be taken in relation to public health risks arising from the supply of water and sewerage services by any public and private provider, the Council is satisfied that sufficient separation exists to avoid conflicting interests.

Service standards and PAWA's remaining regulatory functions

The Council is concerned that PAWA is currently responsible for setting its own service standards. The Council also notes that full separation of service provision and

regulatory functions is still to be achieved with a number of regulatory functions still to be transferred from PAWA to other agencies.

However, the Northern Territory has initiated reform to address these issues. For example, the Council has been advised that a licensing system similar to that currently being introduced for electricity is also being considered for public and private water and sewerage providers.

An appropriate licensing system could address the Council's concerns in relation to standard setting. Further, the reform timetable provided by the Northern Territory lists a target of June 2000 for passage of legislation to address the Council's remaining second tranche concerns with respect to regulatory separation.

Therefore, while the Council is of the view that second tranche commitments are still to be met, it will review this matter in a supplementary assessment to be conducted prior to July 2000. The Council will look for the passage of legislation to establish appropriate institutional arrangements at that time. This further assessment would be assisted by the provision of, as they become available:

- a copy of the January 2000 review (see Table 3) and details of action to be taken by the Northern Territory in response to the review's recommendations;
- draft and final legislative amendments; and
- copies of the amended legislation when passed.

REFORM COMMITMENT: WATER ALLOCATION AND TRADING

Establishing an appropriate framework for water allocation and trade

Outstanding issue, June 1999

The COAG framework states that in relation to water allocation and trading jurisdictions have agreed to implement comprehensive systems of water entitlements backed by separation of water property rights from land title and clear specification of entitlements in terms of ownership, volume, reliability, transferability and, if appropriate, quality. In conducting its second tranche assessment the Council looked for jurisdictions to have in place the legislative and institutional framework to enable determination of comprehensive water entitlements and the removal of any legislative impediments to trade. However, it was also noted that if legislation had not achieved final parliamentary passage, the Council would recognise the progress towards achieving legislative change.

While the second tranche assessment noted that in the Northern Territory progress had been made towards establishing a comprehensive allocation system, the Council was concerned that, for the most part, water property rights were still tied to the land listed on the licence. The Northern Territory had stated however that by the end of 1999 legislative amendments would be made to remove this administrative impediment.

Developments since June 1999

The Northern Territory has advised that amendments to the *Water Act* which are expected to be introduced to the Legislative Assembly in February/March 2000 and changes to the forms for licences set down by the relevant regulations will:

- remove the tie between the water right and the land listed on a licence; and
- enable trade between consumptive beneficial uses⁵⁹.

In addition to the above, legislative changes are also being made to:

- enable formal declaration of beneficial uses in a water control district by the Administrator through notice in the *Gazette*;
- enable the Minister to declare a water allocation plan for a water control district by notice in the *Gazette*;
- require the Minister to specify a period of not more than ten years (with a review within five years) over which the water allocation plan will remain in force;
- require that water resource management within a water control district is in accordance with a water allocation plan;

⁵⁹ Consumptive beneficial uses listed in the proposed amendments to the *Water Act* are agriculture, public water supply, manufacturing and riparian use. Trade in allocations to non-consumptive beneficial uses, namely, environmental and cultural uses will not be permitted.

- ensure that within a water control district water is allocated to beneficial uses within the estimated sustainable yield which includes an allocation for the environment;
- provide for recovery of the full cost of resource management wherever possible;
- provide for the Minister to establish and appoint members of a Water Advisory Committee where a water control district is declared; and
- require consideration of water allocation plans ahead of discretionary consideration of other matters listed under Section 90 of the Act, where they apply, in granting, amending or modifying a licence.

The Northern Territory has advised that the above amendments are expected to be passed by March/April 2000.

Assessment

The Council is satisfied that the proposed amendments when passed will address its concerns regarding the separation of water property rights and land title and establish an appropriate framework for water allocations and trading. However, the Council will revisit this issue prior to July 2000 to ensure that the legislation has been passed and that any amendments are consistent with COAG commitments.

Action on priority water resources

Outstanding issue, June 1999

The Council's July 1999 assessment noted that for the second tranche, jurisdictions agreed to submit individual implementation programs, outlining a priority list of river systems and groundwater resources including detailed implementation actions and dates for allocations and trading. However, while the Northern Territory provided information on action taken or planned in relation to priority river systems, a number of outstanding issues remained. For example, some aspects of the Northern Territory's research program (such as funding for a number of research projects into environmental needs of the Daly River and Darwin area) had not yet been finalised. The Council therefore agreed to defer consideration of this matter until a finalised implementation program was provided.

Developments since June 1999

In regard to priority water resources, the Northern Territory has advised the Council that in the light of current and projected 5- 10 year demands, there are no stressed water resource systems in the Northern Territory. However, the Northern Territory also states that longer term strategic planning identifies priority resources in the Ti Tree Region, Katherine Region and Darwin Rural Area. Also, water allocations in the Alice Springs area are currently being reviewed. Action to be taken in relation to each of these resources is outlined in Attachment 1.

Assessment

The Council is satisfied that tranche two commitments in relation to the provision of an implementation timetable for action on priority resources have now been met.

Attachment 1: Action to be taken in relation to priority water resources

Resource	<i>Identification of environmental flows</i>	<i>Preparation of a resource management strategy</i>
Ti Tree Region	<p>Contingent environmental flow allocation to be released for public comment December 1999.</p> <p>Proposed amendments to the Water Act are expected to result in the declaration of formal allocations to the environment in 2000.</p>	<p>Regional strategy to be released for public comment in December 1999 and will contain the regional allocation plan. Public comment will be invited up to February 2000 and declaration of the allocation plan and operational commencement of the regional plan will occur in April 2000.</p>
Katherine Region	<p>Research program to identify environmental requirements to commence end 1999 for completion end 2001.</p> <p>Allocations for the environment will be determined through regional planning process, consultation and the above research program. A contingent allocation for the environment will be released for public comment in July 2000 as part of a draft regional resource management plan. Formal declaration of the allocation plan will be made at end of 2001 after public consultation.</p>	<p>Extension to regional plan expected to be completed June 2000 and released for public comment I July 2000. Public consultation will extend over at least 12 months and will result in formal declaration of the regional water allocation plan, including allocation to the environment, at end of 2000. The findings of environmental water requirements research will be fed into the progressive development of the regional allocation plan.</p>
Darwin Rural and Greater Region	<p>Environmental requirements currently being assessed through groundwater research project at NT University and will be reported in regional plan due 2000. Proposed amendments to Water Act will facilitate declaration of environmental allocations in 2000</p>	<p>Regional strategy to be completed in 2000 and incorporating a regional water allocation plan which will include a contingent allocation to the environment and ongoing research program based on local research and research from the Daly River area in Katherine Region.</p>
Alice Springs Region	<p>Regional water allocation plan, including environmental water allocation encompassing at least all regional river flow, will be declared early in 2002. This will be included in the regional resource management plan to be developed over the time-frame.</p>	<p>Development of the regional resource management plan has commenced with early 2001 targeted for release of a draft strategy for public comment, including a preliminary water allocation plan incorporating an allocation for the environment. Operational commencement of the regional strategy, and formal declaration of the water allocation plan, is expected early in 2002 following 12 months public consultation.</p>

Source: Northern Territory Department of Lands Planning and the Environment.

OTHER REFORMS: SOUTH AUSTRALIA

Electricity

Outstanding issue, June 1999

The Council's stated in its second tranche assessment report that:

'South Australia proposes to establish the regulatory bodies recommended in the clause 4 review by August 1999. The Council will undertake an interim assessment of South Australia's progress before 31 December 1999.'

Developments since June 1999

The Council is aware that the South Australian Independent Industry Regulator (SAIIR) was established on 11 October 1999 following enactment of the *Independent Industry Regulator Act 1999* and the *Electricity (Miscellaneous) Amendment Act 1999*. The SAIIR's responsibilities include the regulation of pricing and access for distribution networks, and administering the licensing of electricity entities. The separation of these industry regulation responsibilities from the public monopoly, ESTA, is in accordance with the structural reform of public monopolies required under NCP reforms.

Assessment

The Council considers that South Australia has met its second tranche electricity reform commitments as the regulatory framework required under the NCP agreements has been satisfied. The next Council assessment of all jurisdictions' progress against electricity reform commitments is in June 2001.

Gas

Outstanding issue, June 1999

The Council was unable to provide a positive assessment of South Australia's progress in removing regulatory barriers to free and fair trade until it received notification of South Australia's official response to the review of the *Cooper Basin (Ratification) Act 1975*. The Council noted that it would consider this matter in the context of a supplementary assessment to be made on 31 December 1999.

Developments since June 1999

The Council has not been provided with further information concerning this reform commitment. South Australia has advised that information will be provided during December 1999. However, at this late stage the Council will not be in a position to review the information and make a recommendation to the Treasurer prior to 31 December 1999.

Assessment

The Council makes no further recommendation to the Treasurer concerning this reform commitment. The Council will continue to seek further information and assess South Australia's compliance with reform commitments in the near future.

APPENDIX: Second tranche assessment framework – water reform

REFORM COMMITMENT: COST REFORM AND PRICING

Major Urbans and Non-Metropolitan Urbans

Drawing on the advice of the Expert Group and complying with the ARMCANZ full cost recovery guidelines, jurisdictions are to implement full cost recovery.

Water businesses must price between a floor price which allows for the continuing commercial viability of the system and a ceiling price which incorporates asset values and a rate of return but does not include monopoly profits:

- the floor price includes provision for future asset refurbishment or replacement using an annuity approach where service delivery is to be maintained; and
- the ceiling price includes provision for asset consumption and cost of capital calculated using a weighted average cost of capital (WACC).

Within the band, a water business should not recover more than operational, maintenance and administrative costs, externalities, taxes or tax equivalent regimes (TERs), the interest costs on debt, and dividends (if any) set at a level that reflects commercial realities and simulates a competitive market outcome.

The level of revenue should be based on efficient resource pricing and business costs. In determining prices, community service obligations (CSOs), contributed assets, the opening value of assets, externalities including resource management costs, and TERs should be transparent. The deprival value methodology should be used for asset valuation unless a specific circumstance justifies another method.

Jurisdictions must implement consumption based pricing. Two part tariffs are to be put in place by 1998 where cost effective. Metropolitan bulk water and wastewater suppliers should charge on a volumetric basis.

Jurisdictions are to apply two part tariffs to surface and groundwater comprising a fixed cost of access component and a volumetric cost component.

Metropolitan bulk water and wastewater suppliers must establish internal and external charges to include a volumetric component or two part tariff with an emphasis on the volumetric component to recover costs and earn a positive real rate of return.

Jurisdictions are to remove cross subsidies, with any remaining cross subsidies made transparent (published).

For the purposes of the framework, a cross subsidy exists where a customer pays less than the long run marginal cost and this is being paid for by other customers. An economic measure which looks at cross subsidies outside of a Baumol band, which sets prices between incremental and stand alone cost, is consistent with the COAG objective of achieving economically efficient water usage, pricing and investment outcomes. To achieve the COAG objective, potential cross-subsidies must be made

transparent by ensuring the cost of providing water services to customers at less than long run marginal costs is met:

- as a subsidy, a grant or CSO; or
- from a source other than other customer classes.

Where service deliverers are required to provide water services to classes of customers at less than full cost, this must be fully disclosed and, ideally, be paid to the service deliverer as a community service obligation.

All CSOs and subsidies must be clearly defined and transparent. The departure from the general principle of full cost recovery must be explained. The Council will not make its own assessment of the adequacy of the justification of any individual CSO or cross-subsidy but will examine CSOs and cross-subsidies in totality to ensure they do not undermine the overall policy objectives of the strategic framework for the efficient and sustainable reform of the Australian water industry.

Publicly owned supply organisations should aim to earn a real rate of return on the written down replacement cost of assets for urban water and wastewater.

Jurisdictions are to have achieved progress toward a positive real rate of return on assets used in the provision of all urban water supply and wastewater services.

Rural Water Supply and Irrigation Services

Where charges do not currently cover the costs of supplying water to users (excluding private withdrawals of groundwater),⁶⁰ jurisdictions are to progressively review charges and costs so that they comply with the principle of full cost recovery with any subsidies made transparent.

Jurisdictions should provide a brief status report, consistent with advice provided to ARMCANZ, on progress towards implementation of pricing and cost recovery principles for rural services.

The Council will assess jurisdictions as having complied with the pricing principles applicable to rural water supply where jurisdictions:

- have achieved full cost recovery; or
- have established a price path to achieve full cost recovery beyond 2001 with transitional CSOs made transparent; or
- for the schemes where full cost recovery is unlikely to be achieved in the long term, that the CSO required to support the scheme is transparent; and

⁶⁰ Private withdrawals of groundwater include private providers and small co-operatives who extract water from bores for private use, but does not include large co-operative arrangements (including trusts) that act as wholesalers supplying water as a commercial venture and that are subject to control or directions by government or receive substantial government funding.

- cross-subsidies have been made transparent.

Jurisdictions are to conduct robust independent appraisal processes to determine economic viability and ecological sustainability prior to investment in new rural schemes, existing schemes and dam construction. Jurisdictions are to assess the impact on the environment of river systems before harvesting water.

Policies and procedures must be in place to robustly demonstrate economic viability and ecological sustainability of new investments in rural schemes prior to development. The economic and environmental assessment of new investment must be opened to public scrutiny.

Jurisdictions must demonstrate a strong economic justification where new investment is subsidised.

Jurisdictions are to devolve operational responsibility for the management of irrigation areas to local bodies subject to appropriate regulatory frameworks.

All impediments to devolution must be removed. Jurisdictions must demonstrate that they are encouraging and supporting devolution of responsibility, including through education and training.

REFORM COMMITMENT: INSTITUTIONAL REFORM

Institutional Role Separation

As far as possible the roles of water resource management, standard setting and regulatory enforcement and service provision should be separated institutionally by 1998.

The Council will look for jurisdictions, at a minimum, to separate service provision from regulation, water resource management and standard setting. Jurisdictions will need to demonstrate adequate separation of roles to minimise conflicts of interest.

Metropolitan service providers must have a commercial focus, whether achieved by contracting out, corporatisation, privatisation etcetera, to maximise efficiency of service delivery.

Incorporate appropriate structural and administrative responses to the CPA obligations, covering legislation review, competitive neutrality, structural reform.

Performance Monitoring and Best Practice

ARMCANZ is to develop further comparisons of interagency performance with service providers seeking best practice.

Jurisdictions have established a national process to extend inter-agency comparisons and benchmarking. Benchmarking systems are to be put in place for the NMU and rural sectors, "WSAA Facts" is to be used for major urbans, and service providers are to participate.

The Council will accept compliance for the three sectors subject to the Productivity Commission confirming consistency with the Report of the Steering Committee on National Performance Monitoring of Government Trading Enterprises, *Government Trading Enterprises Performance Indicators*" (Red Book). The Productivity Commission has already confirmed the consistency of "WSAA Facts" for the major urbans. The Council recognises the first reports for the NMU and rural sectors are likely to be a rough cut in the initial years.

REFORM COMMITMENT: ALLOCATION AND TRADING

There must be comprehensive systems of water entitlements backed by separation of water property rights from land title and clear specification of entitlements in terms of ownership, volume, reliability, transferability and, if appropriate, quality.

A 'comprehensive' system requires that a system of establishing water allocations which recognises both consumptive and environmental needs should be in place. The system must be applicable to both surface and groundwater.

The legislative and institutional framework to enable the determination of water entitlements and trading of those entitlements should be in place. The framework should also provide a better balance in water resource use including appropriate allocations to the environment as a legitimate user of water in order to enhance/restore the health of rivers. If legislation has not achieved final parliamentary passage, the Council will recognise the progress towards achieving legislative change during its assessment of compliance.

Jurisdictions must develop allocations for the environment in determining allocations of water and should have regard to the relevant work of ARMCANZ and ANZECC.

Best available scientific information should be used and regard had to the inter-temporal and inter-spatial water needs of river systems and groundwater systems. Where river systems are overallocated or deemed stressed, there must be substantial progress by 1998 towards the development of arrangements to provide a better balance in usage and allocations for the environment.

Jurisdictions are to consider environmental contingency allocations, with a review of allocations five years after they have been initially determined.

Jurisdictions must demonstrate the establishment of a sustainable balance between the environment and other uses. There must be formal water provisions for surface and groundwater consistent with ARMCANZ/ANZECC "*National Principles for the Provision of Water for Ecosystems*".

Rights to water must be determined and clearly specified. Dormant rights must be reviewed as part of this process. When issuing new entitlements, jurisdictions must clarify environmental provisions and ensure there is provision for environmental allocations.

For the second tranche, jurisdictions should submit individual implementation programs, outlining a priority list of river systems and groundwater resources, including all river systems which have been over-allocated, or are deemed to be stressed and detailed implementation actions and dates for allocations and trading to the Council for agreement, and to Senior Officials for endorsement. This list is to be publicly available.

It is noted that for the third tranche, States and Territories will have to demonstrate substantial progress in implementing their agreed and endorsed implementation

programs. Progress must include at least allocations to the environment in all river systems which have been over-allocated, or are deemed to be stressed. By the year 2005, allocations and trading must be substantially completed for all river systems and groundwater resources identified in the agreed and endorsed individual implementation programs.

Arrangements for trading in water entitlements must be in place by 1998. Water should be used to maximise its contribution to national income and welfare.

Where cross border trade is possible, trading arrangements must be consistent between jurisdictions and facilitate trade. Where trading across State borders could occur, relevant jurisdictions must jointly review pricing and asset valuation policies to determine whether there is any substantial distortion to interstate trade.

Jurisdictions must establish a framework of trading rules, including developing necessary institutional arrangements from a natural resource management perspective to eliminate conflicts of interest, and remove impediments to trade. The Council will assess the adequacy of trading rules to ensure no impediments. If legislation has not achieved final parliamentary passage, the Council will recognise the progress towards achieving legislative change during its assessment of compliance.

As noted above, for the second tranche, jurisdictions should submit individual implementation programs, outlining a priority list of river systems and groundwater resources and detailed implementation actions and dates for allocations and trading to the Council for agreement, and to Senior Officials for endorsement. This list is to be publicly available.

Cross border trading should be as widespread as possible. Jurisdictions are to develop proposals to further extend interstate trading in water.

REFORM COMMITMENT: ENVIRONMENT AND WATER QUALITY

Jurisdictions must have in place integrated resource management practices, including:

- **demonstrated administrative arrangements and decision making processes to ensure an integrated approach to natural resource management and integrated catchment management;**
- **an integrated catchment management approach to water resource management including consultation with local government and the wider community in individual catchments; and**
- **consideration of landcare practices to protect rivers with high environmental values.**

The Council will examine the programs established by jurisdictions to address areas of inadequacy. Programs would desirably address such areas as government agency co-ordination, community involvement, co-ordinated natural resource planning, legislation framework, information and monitoring systems, linkages to urban and development planning, support to natural resource management programs and landcare practices contributing to protection of rivers of high environmental value.

Support ANZECC and ARMCANZ in developing the National Water Quality Management Strategy (NWQMS), through the adoption of market-based and regulatory measures, water quality monitoring, catchment management policies, town wastewater and sewerage disposal and community consultation and awareness.

Jurisdictions must have finalised development of the NWQMS and initiated activities and measures to give effect to the NWQMS.

REFORM COMMITMENT: PUBLIC CONSULTATION, EDUCATION

Jurisdictions must have consulted on the significant COAG reforms (especially water pricing and cost recovery for urban and rural services, water allocations and trade in water entitlements). Education programs related to the benefits of reform should be developed.

The Council will examine the extent and the methods of public consultation, with particular regard to pricing, allocations and trade. The Council will look for public information and formal education programs, including work with schools, in relation to water use and the benefits of reform.

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