6th May 2002

Mr Paul Swan
Acting Director
Water Reform
National Competition Council
GPO Box 250B
Melbourne Vic 3001

Re: The 2002 NCP Assessment Framework For Water Reform ("NCP Framework")

Dear Mr Swan,

We refer to your letter of the 27th February 2002, and our previous correspondence to Mr Owens of your office, dated 16 January 2002, on National Competition Policy Implementation in Tasmania by local Government. In referencing this, we would like to state that we believe that Tasmania is significantly behind the mainland States in water reform for metropolitan users.

Many of these problems relate to the unique ownership of water and sewerage assets in Tasmania and the failure of State and Local Governments to separate the ownership and management of these assets. The regulatory framework has also been severely compromised with no apparent review mechanisms to ensure transparency, equity and good governance of a valuable resource for consumers and the environment.

These problems were demonstrated by the methods used to review and conduct the 1999 studies into the Corporatisation Public Benefit Test, the water and sewerage services and the Two-Part Water Pricing - Cost Effectiveness Study. The underlying assumptions, conduct and review of the studies were fundamentally flawed. An example was that GPOC was not allowed to review these studies . While we strongly urge that these studies should be reviewed by the National Competition Council ("NCC") and new objective studies commissioned due to the reasons previously outlined in our letter to Mr Owens (item1 copy attached and in particular pages 6 to 11) we will focus in this submission on the issues outlined in the NCP Framework.

1. Background

It is our opinion that Southern Tasmanian Councils (excluding Brighton which is probably the poorest local government in the area) have demonstrated over the last 5 years a lack of commitment to NCP for water reform. We will in particular use Hobart City Council and it's attitude to water reform to exemplify our points, however it could be applicable to any of these Southern Councils (excluding Brighton). In addition, we will draw your attention to some alarming developments in Northern Tasmania, which is causing us concern and undermines the long term commitment to the two part tariff pricing system.

2. Pricing and Cost Recovery: Urban

In Tasmania the Government Pricing Oversight Commission ("GPOC") only regulates the wholesale price of water. GPOC does not regulate or review the retail price of water. In fact, the problem is worse from a regulatory standpoint. If we look at the Southern Tasmanian Councils which includes Hobart, Clarence, Sorrell, Brighton, Kingsborough, Glenorchy, New Norfolk, Sorell and Huonville, only Brighton has a two part tariff pricing for water (item 2 shows the % metered). The wholesaler is Hobart Water, which is owned by the Southern Tasmanian Councils who are each independently the retailer. There is **"no gatekeeper"** for water users. It is illogical to have the wholesaler regulated and the retailers not regulated. How can this structure result in an efficient, equitable and transparent pricing regime?

The effect of this regulatory regime is extortion pricing for water, as demonstrated by the chart (item 3) which shows that our properties in Hobart are costing $4.55 per KL on an actual usage basis. If the properties were in the City of Glenorchy, the cost would be $8.42 per KL, and if in the City of Brighton $0.66 per KL (which is the only city in Southern Tasmania which has a two part tariff pricing regime). There are some buildings in Hobart where the cost of water is $18 per KL, if calculated on a usage basis. The same issue is for sewerage which all the local governments in Tasmania have failed to address (item3 comparison of sewerage charges).

We are concerned that some Councils such as Hobart, while not yet adopting Full Cost Recovery for water and sewerage, have been revaluing their water and sewerage assets over the last 3 years, with no independent party being responsible for reviewing the appropriateness of these revaluation, unlike GPOC when reviewing the value of the assets of Hobart Water. Consequently when Full Cost Recovery is introduced in Hobart, it is possible the cost of water and sewerage will probably double or triple which in our example will result in water costing $9 to $13 a KL.

In Tasmania there is no gatekeeper monitoring the values placed on water and sewerage assets by local government or the pricing of water and sewerage as GPOC only regulates the wholesale price. In addition because local governments such as Hobart do not identify cross subsidies or CSOs (which we will discuss later) the burden will always excessively fall onto water users and not shared by ratepayers.

If we analyse the City of Glenorchy (item 4 Annual Report 2001) you will notice that they have Full Cost Recovery for water and sewerage, and in fact are making a profit. However Glenorchy has not been revaluing assets like Hobart (item 4 Annual Report 2001) but they do not identify CSOs or cross subsidies. Consequently the water user is picking up an excessive burden as evidenced by the pricing chart for water.

These examples again illustrate that there are no gatekeeper for consumers. Local Governments can revalue assets and charge as much as they like for water and sewerage services without having to justify their prices. The only way GPOC can investigate the water and sewerage businesses of local government is if the State Government requests GPOC to investigate. This is an ad hoc review mechanism and is totally inadequate to safeguard consumers. The NCC needs to ensure that GPOC is an effective regulator, with appropriate legislative authority for overseeing the price of water for consumers at both the wholesale and retail level.

A final question which we pose is, who owns the water assets? In the case of water authorities such as Hunter, Sydney or Melbourne Water, the State Government effectively owns the assets and it could be argued they should receive a return on funds employed either as a dividend or as retained assets to further development of these assets. However in the case of the local government in Tasmania, who contributes and owns the water and sewerage assets? Who actually paid for these assets? The water users or the ratepayers? If Full Cost Recovery is not regulated, then for example local governments such as Glenorchy will continue with water users subsidising the ratepayers, and in fact it will get worse with the revaluation of assets.

Some may argue that the water users have already paid for these assets and they should not be charged twice by Councils, whereby the Councils make a profit on the assets and use it for general revenue. We submit that the water and sewerage business and assets should be appropriately **"ring fenced"** (which would have happened with corporatisation) otherwise without proper pricing regulation, water users are going to be continuingly gouged. Some would argue this is already happening.

3. Consumption Based Pricing

We believe that the reports into Corporatisation and Two Part Tariff Pricing were fundamentally flawed and have enclosed them for your review, together with our letter to Mr Owens, which highlighted our concerns. We also attach the corporatisation tests from Glenorchy, North Midlands and Hobart (item 5) so you can make an independent assessment as to their quality and rigor on such important issues. It is submitted that the process was severely compromised and it has delivered a poor outcome to water users and the environment.

If these reports are not reviewed, there is little chance for consumption based pricing in Southern Tasmania. We refer to the chart (attached) which clearly shows that commercial water users are being over charged for water on a consumption basis. In fact the more water residential or non-residential users use, the cheaper it is. This is extremely disturbing that the policy actually benefits large water users and wasteful water practices.

This aspect is also alarming because even if these local governments continue without two part pricing, why should large water users who are metered contribute to their fair share of the fixed costs of water. Given that the majority of commercial users are metered, the large water users are charged at the excess water rate, which in the case of Hobart is $0.56 per Kl. Therefore large water users such as Cascade or National Foods do not contribute to the fixed costs of water. Why should we be charged $4.55 per KL for using less water (ie picking up a large fixed component) and Cascade or National Foods only being charged the marginal cost of water, even though they use excess water each year? Another example is, when large ships use water they are only charged at the marginal cost of water. It should be noted that the cost of bulk water from Hobart Water is $0.44 per KL. This pricing mechanism is the same for all Southern Tasmanian Councils except Brighton. This is totally illogical and shows that local governments in Tasmania do not understand the correct pricing for water. Theoretically the price of water should be between $0.80 and $1.10 per KL of water on a volumetric basis. If GPOC had a more active role in the pricing of water, local government would begin to understand the real costs and price accordingly.

This problem is continuing in Southern Tasmania whereby the City of Hobart for example, still does not require water meters on new residential buildings (item 6 page 5 letter from Mr Street dated 4th April 2002). This type of policy only exasperates the problem and demonstrates that the City has no desire to ever implement water reform or understands the economic or environmental issues.

The continuation of By Laws such as that by the City of Hobart (item 7) to not allow the sale of water by property owners or transfer water between other properties owned by the same person only results in the incorrect of water. Proper pricing for the consumption of water is desperately required in Southern Tasmania.

Another example of the duplicity by local government in Southern Tasmania is the City of Clarence which charges some residential areas in the City which have meters for excess water but other residential properties which do not have water meters can use as much as they desire, yet the City has no policy to meter the City or charge on a user pays principal where meters are installed. It should be expected that in this situation they should be able to charge appropriately for water where users have a recognised meter (ie for excess water purposes).

This could also be the situation in Hobart, whereby most non-residential users are metered . Why should local governments be allowed to charge on a user pays basis for excess water but not on the base water usage? This is a continuation of the fraud and distortion of the water market and this happens throughout Southern Tasmania. Local Governments should not be allowed to have it both ways. It is our opinion, that if a local government can charge for excess water, then they should be required to price water correctly and charge on a user pays basis, the correct price for water, and not on an AAV basis or a hybrid.

Another problem which is developing in Northern Tasmania is that many local governments were required to proceed with a two part tariff pricing system after the 1999 review. It was extremely controversial and the local governments did an extremely poor job in the implementation of water reform. Through a lack of education and awareness and separation of the rates bill (which included the fixed

water component) ratepayers received another bill only for water usage. The ratepayer did not understand they were still paying a fixed component in the rates for water. Therefore the ratepayers have gotten upset and believe they are being excessively charged for water.

Theoretically what should happen over time is that the volumetric price of water should increase and the fixed cost decline. What is happening in Northern Tasmania is local governments are increasing the fixed component which is hidden in the rate bill as part of the AAV and decreasing the volumetric charge for water.

While some may argue there is a two-part tariff pricing policy in Northern Tasmania, we believe it is now being hijacked by politicians for expediency and is developing into a **"Clayton's" consumption based pricing system.** This is another reason why it is critical for a regulator to be in charge of the pricing of water, or at the very least reviewing Local Governments pricing policy.

4. Community Service Obligations ("CSOs")

The Local Governments in Southern Tasmania, excluding Brighton, has failed in their annual reports to identify any CSOs, including the water and sewerage businesses. We believe that the Cities have either failed to understand their obligations or do not want to. We enclose correspondence with the Hobart City Council on this matter, which clearly shows their own commitment to identifying CSOs. Their defence is that the State Government has not said anything to them (item 8 page 3 letter from General Manager HCC) yet in the NCC review it clearly states these issues need to be addressed (item 9) .

The HCC stated that The Council has completed these various investigations and has assumed in the absence of any comment from State Government, that Council has satisfactorily carried out these undertakings and is in compliance with the State Government NCP requirements. He went onto to say *" … and that no CSO's were identified in accordance with the definitions provided which excluded pensioner rebates amongst others*".

Because of the State Government's approach to Local Government on endeavouring to have a cooperative approach in developing partnership agreements, it restricts the State Government from enforcing various obligations onto local government. We attach an excerpt from the State Government's partnership agreement with the City of Hobart on NCP (item 9). We believe it adequately illustrates the issue. The failure of local government to identify CSOs does not just relate to the water and sewerage businesses.

Except for Brighton, no local government in Southern Tasmania meters and monitors it's own water and sewerage use. The water and sewerage users are subsidising the ratepayers as the water and sewerage businesses are not reimbursed from general revenue. Consequently these businesses are obtaining a lower return because they are not charging all users for their water and sewerage services. These businesses have not been separated from the activities of Council as what was as suggested or required under full cost attribution.

It is our opinion that Local Government uses between 5 to 10 % of all water. If this assumption is correct and if water was priced efficiently, the CSO would be very large. The local government would then meter and monitor their usage, and if they reduced their consumption by 10 to 20 % as would be expected, the savings for ratepayers and the environment would be substantial. There is no requirement on local government to meter their own usage to identify CSOs or cross subsidies even though it makes good commercial and environmental sense. We estimate that it makes financial sense for local government to meter and monitor their own usage with a return of investment through reduced consumption of between 10 and 20% per annum even on conservative assumptions. Presently we are not aware of any Southern Tasmanian Local Governments who has any commitment to identify it's CSOs in the near future

In addition, the lack of identification of CSO's has resulted in the revenue for the water business being underestimated in the corporatisation and two-part tariff pricing studies. This would have resulted in a major impact on the outcome of the studies. The Department of Premier and Cabinet Local Government Division Policy Community Service Obligation Policy and Guidelines for Local Government in Tasmania dated November 2000 (item 10) says on page 6,

> *"Council must identify existing CSO's and establish costing, funding, reporting and contracting principles of this policy in sufficient time to demonstrate adequate compliance with this NCP reform commitment prior to the third tranche assessment by the NCC in June 2001.*
>
> *Councils are required to develop a program for identification and review of CSO's and provide sufficient evidence to demonstrate ongoing compliance with this NCP reform element".*

The NCP June 2001 Assessment said,

> *"Tasmania has advised that Local Governments have commenced reporting on their water and wastewater services CSO's to the Department of Premier and Cabinet, as required under the revised GPOC Guidelines issued to Council in April 2001 (item 10) However almost all have reported no CSO's to date. Tasmania note that this will be addressed as part of the Commission's audit".*

There should be no problem in identifying CSO's. The only problem is the reluctance of Local Government to become more responsible and accountable managers. The attitude of the largest City and the capital of Tasmania, Hobart regarding CSOs is obvious when the General Manager says in February 2002 **"that no CSO's were identified".** The NCC must take a firm approach when dealing with these recalcitrant Local Governments, which make no attempt to change their ways and assist in meeting national initiatives.

Please note the Urban Pricing Guidelines Revised March 2001 (item10) gives clear examples to Local Government regarding CSO's for water when it states:

"The reporting format provides for the recognition of the cost of CSO's as a transfer from Council's general funds to its water operations. This is treated as a revenue item for the water business that offsets the costs of the activity, or the revenue foregone though the provision of a concession.

If the CSO activity or concession were not recognised and accounted for, the effect would be that the cost of the CSO would be met by charges to water users , resulting in a cross-subsidy being paid by water users to provide the CSO."

Local Governments' failure to identify CSOs results in councillors, staff and ratepayers having no idea what classes of consumers are receiving benefits and how much the benefits are. We believe these types of benefits should either be funded by ratepayers or the State Government, not water users. An example would be a business which does not pay the appropriate price for water. Perhaps the State Government, not ratepayers, should be funding it, as it is a business of State significance.

Local Governments have no idea about the real cost of water and sewerage. It is unfortunate that corporatisation did not proceed with the Water and Sewerage businesses as it would have forced many Local Governments to address these issues and meet the challenges. The attitude of the Hobart City Council is endemic of all the Local Governments in Southern Tasmania and demonstrates that they do not have the will to change.

5. Cross Subsidies

There is no doubt that in Southern Tasmania there is significant cross subsidies. Local Government should be forced to identify the cross subsidies between residential and non-residential users, as well as between large and small users. Unfortunately because the local government in Southern Tasmania fails to price water appropriately, they are incapable of identifying the cross subsidies. This is where the regulator could be extremely helpful in showing local government the actual cost to different classes of users, how their archaic business and pricing practices can be improved and the benefits to the economy of micro economic reform. The issue raised above on local government monitoring it's own water and sewerage business and the ratepayers being charged for this usage maybe a cross subsidy instead of a CSO as identified above. Whatever it is, it is not being addressed by any Southern Tasmanian Council except Brighton.

6. Commercial Focus

The local government water providers in Southern Tasmania fail to have any commercial focus whatsoever. This is evident in their failure to contract out services. An example of this is the City of Hobart, which claimed in the 1999 Cost Benefit Corporatisation Study, which stated the Service provider Civic Solutions was corporatised when in fact it was not. It was identified in previous annual reports as a Significant Business Activity ("SBA") but last year was deleted as a SBA. In addition, Hobart City Council does not competitively tender for major services performed by Civic Solutions nor did it ever show revenue in the annual report as a SBA (effectively a cost centre).

None of the Southern Tasmanian Councils benchmark or have examined the merger or consolidation of their water and sewerage businesses. This obviously would make the most sense. There should be an objective study into the transfer of all water and sewerage assets by each of the Southern Tasmanian Councils to Hobart Water. This should not be a problem, as these Councils already own Hobart Water. Hobart Water could then extract the efficiencies from having the ownership and management of all the water and sewerage assets. Real micro economic reform with real and tangible benefits. It would also ensure politics will be removed and result in a commercial focus. What is also important to consumers is that GPOC could then be the made the regulator of the retail price. **An effective gatekeeper**. This is what the NCC should be pushing the State Government to do. An objective and comprehensive review with a commercial focus. Consolidating all the water and sewerage businesses of the Southern Tasmanian local governments into one Water Authority.

7. Public Consultation and Education

We refer to previous correspondence on this matter and submit that Local Government and the State Government failed in their duty to educate ratepayers and consumers on water reform as evidenced in my submission on how the Corporatisation Public Benefit and Two Part Tariff Pricing Studies were handled.

8. Summary

Water Reform and the commitment of Local Government to the principles of NCP is sadly lacking in Tasmania and in particular Southern Tasmania. Issues such as CSOs and cross subsidies are continuing not to be addressed because there is a lack of leadership and a " big stick". The State Government's approach to dealing with Local Government is a major concern. They must be more proactive. However, the issue which the NCC must address is the regulatory framework.

How can GPOC regulate the wholesaler and not the retailer? The retailer's profits are only being enhanced by this approach with no benefit being passed to consumers. The current regulatory framework ensures the status quo. The current framework is archaic and ensures the economy and the environment are not a priority. The situation in Southern Tasmania is different to what the NCC has mainly encountered in dealing with water reform and therefore the **rules of engagement** need to be different to handle these issues. If GPOC was able to regulate the retail pricing of water and sewerage services provided by local government, we are sure many of the problems and inefficiencies would be addressed and resolved. At the very least they would be identified. The current system is both inadequate and we would argue not sustainable.

We thank you for the opportunity to make a submission, and if you require any additional information, please do not hesitate to contact me.

Yours Truly

Robert Rockefeller

swan1:rr/cw