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House of Representatives

Standing Committee on Agriculture, Fisheries and Forestry

Parliament House
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Inquiry into Future Water Supplies for Australia's Rural Industries and Communities

Secretary: *[Signature]*.....

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HOUSE OF REPRESENTATIVES
 STANDING COMMITTEE ON
 AGRICULTURE, FISHERIES
 AND FORESTRY

We have been investors in Tasmania for many years. We have taken an active interest in the implementation of National Competition Policy in the State and the impact it has had on the water and sewerage industries. We believe that for customers whether agricultural, businesses or individuals to appreciate water they must be charged the actual cost of delivering the product as well as being charged the actual cost for utilising the product (ie waste/sewage) of that product. It is only when this occurs that there will be proper conservation of water.

In addition it will also ensure that there is sufficient investment in the delivery of water and the waste treatment of water. It is important for all users to understand the full cost of using water. In Tasmania we believe this has not occurred even though the National Competition Council ("NCC") had good intentions when established. Commonwealth policy and programs are critical to improving the competing demands on water. It is important that a national and state outcomes are achieved not local or regional as the issue of water is too important

National Competition Policy ("NCP")

In our submission we have tried to focus on Water Reform in Local Government in Tasmania. If we examine Southern Tasmania the water usage is almost twice most other urban areas in Australia (see item 1). A major reason is most cities in Southern Tasmania do not have water meters and charge on an AAV basis. Limited user pays charges for water and sewerage. While NCP has focused on the correct pricing of water we believed it has failed to address sewerage or the environment impact/cost of using the resource. We also attach a schedule showing all water usage in each local council in Tasmania (see item 2).

It is noticeable that usage across Tasmania is significantly above the national average. In addition many local governments in Tasmania do not identify Community Service Obligations ("CSOs) for water usage. For example they do not even meter their own water usage and charge the appropriate section of the council department for the water they use such as the parks department. The local councils treat the consumption of water as a free commodity. This is in contravention of both the NCC and State CSO guidelines. This is just one reason why institutional reform is required in Tasmania and local councils should not be responsible for retailing of water and sewerage. The Commonwealth must play a more active role in water conservation and management.

Regulation of Water in Tasmania

In Tasmania there are 3 bulk water suppliers. These are Esk, North West and Hobart Water Authority. These authorities are regulated in their pricing by the Government Pricing Oversight Authority ("GPOC"). The bulk water suppliers are owned by their respective local councils in the area. The local councils each independently retail water and sewage services. The regulator does not regulate the retail price of these services. The "Gate Keeper" is ineffective unlike what occurs in most States in Australia where the regulator actually regulates the retail price for water and sewerage.

Thinking Locally and Not Regionally

In 1995 a study was commissioned by the Tasmanian Roles and Functions Review Committee for London Economics to review the structure of the water and sewage treatment in Tasmania. We attach as item 3 the final report which recommended institutional reform of the retailing of water and sewerage businesses with the bulk water suppliers.

This would have resulted in significant savings to ratepayers from these recommendations through efficiencies as well as would have resulted in water and sewerage being planned on a regional basis. In addition this institutional reform would have resulted in the activities currently being conducted by local councils "Ring Fenced". The reason why this is important is revenue which was made from water and sewerage would have been reinvested into the water and sewerage businesses. Unfortunately Local Government fought these reforms because they would lose control. Arguably instead of acting in the best interest of ratepayers or Tasmania they acted in self interest.

Important resources such as water need to be able to be regulated on a regional basis. It needs proper regulations and pricing to be developed and proper investment in infrastructure.

Pricing for Water and Waste Water

In Tasmania local councils either charge for water on a quasi two part tariff pricing for water or an AAV basis. Both methods make little sense. It should be noted that in relation to waste water they either charge on an AAV basis or a fixed price basis. Again both methods do not make sense.

AAV stands for assessed annual value which is the council rating system used in Tasmania. They are the only State in Australia which uses this method for council rating purposes.

In the case of councils charging for water on an AAV basis, this occurs mainly in Southern Tasmania and it is little wonder given there are no meters that water

consumption is the highest in Australia. Meters are an important mechanism to make consumers more responsible for the use of water. No where else in Australia do major residential areas not have water meters.

However the other key area to ensure that consumers are responsible in using water besides metering is the pricing mechanism. In many areas of Tasmania where they have meters they only have a quasi system of two part tariff pricing for water. They still charge a significant component by AAV for water connection (ie the fixed price) and only a minimal amount for water usage. We attach a rating schedule for Devonport(see item 4).

Consequently, as we know around Australia water should cost on average say \$1KL which is still very cheap for 1000 litres and then some component of fixed cost. The fixed cost should be the same for every user. This is an effective and equitable user pays water system and will result in appropriate funds to reinvest in the infrastructure.

In the case of waste water all local governments either use AAV or a few a fixed prices per connection. As you are aware most water authorities around Australia are now charging waste water on a user pays system. This is the only method for the consumer to begin to understand the real cost of water and conserve it. Water in generally means water out (waste water).

Proper pricing and metering is the only way Tasmanians will become more water conscious. The current methods are ineffective and have been manipulated for political reasons by local governments whether they have or do not have meters.

Investment in Infrastructure

Currently local governments are not required to "Ring Fence" their water and sewage businesses. This means that local government can charge whatever they like for the services with minimal accountability. However what is far more worrying is the money raised from charging for these services can be used for whatever purpose the local council deems appropriate. There is no setting aside these monies for the water and sewerage businesses . Consequently there is no protection for consumers that sufficient funds are being set aside for water related infrastructure. The businesses should be at least ring fenced and not treated as "cash cows" by local councils with no review mechanisms in place to protect the environment.

Corporatisation Test of the Water and Sewerage Businesses of Local Councils

In 1999 pursuant to NCC requirements Local Government had to prepare public benefit tests into the corporatisation of water and sewerage businesses of local councils. In many cases KPMG was used to make the assessments. We have analysed many of these and attach 2 to show you the quality of them. Unfortunately the loser in these reviews was water and the environment. The outcomes were questionable at best and it was interesting in all tests the public benefits for all local governments came out negative.

(a) **KPMG Reports**

Of the KPMG reports into the public benefit test ("PBT") for corporatising local government water and sewerage businesses which we have reviewed, all state that on the basis of the FCA and Corporatisation Models as defined, the PBT concludes that corporatisation of water and sewerage services is not in the public interest. The Report stated that

"The PBT concludes that the negative outcomes outweigh the likely positive outcomes of corporatisation, which may include

- more transparent pricing and costing of services; and
- a marginal improvement in governance outcomes

We have undertaken some analysis of the sensitivity of this conclusion to changes in the scores and weightings of the evaluation criteria that have been used, and found that this conclusion is valid under a range of scenarios.

We therefore believe that the Council should continue to implement reforms within the FCA Model framework to continue to improve the efficiency and transparency of its water and sewerage services."

It is submitted that the KPMG public benefit reports are fundamentally flawed and the integrity of the process was compromised. We submit that KPMG prepared almost all of the corporatisation public benefit tests for local government in Tasmania and on what our sources have indicated, each council was a minimal fixed fee consultancy. If there was a rigorous assessment process for each council, the cost would have been far greater.

Another source close to local government believes that the KPMG approach was distinctively light handed to ensure future consultancy opportunities with this level of government. This was then demonstrated by KPMG getting many of the two part pricing studies shortly thereafter. Furthermore the findings from almost all PBT Reports were identical .

We contend that there was no critical or objective establishment of principles and guidelines for any of the public benefit tests. In addition there was no public consultation or involvement as suggested by the National Competition Council or the Tasmania Government (see page 2 of report). The tests were done in consultation with local government (page 15) with no independent scrutiny to ensure that the PBT was objective and met the guidelines as specified in the NCP Guidelines for PBT (March 1997) and The PBT for Corporatisation of Local Government (Nov 1998) and Corporatisation Principles (Dec 1998). The weighting process was also done in consultation with the relevant councils, and consequently it was subjective in nature. From our analysis all PBT used the same weightings.

The findings by KPMG were negative in all cases even though the local government operations varied significantly as exemplified by Hobart City Council and Northern Midlands Council. (See item 5 and 6). Item 5 outlines the HCC Corporatisation PBT while item 6 compares the Northern Midlands Council and the HCC Corporatisation PBT.

We question whether any sensitivity analysis was done as any change would have changed the outcome given the simplicity of the weighting system.

The Financial Model (see Appendix A of HCC PBT) provides no detail on how the model was constructed or how the potential savings are derived. The assumption that full FCA will be implemented when analysing the two models ensured that the outcome would be negative. In addition to underestimating the savings through corporatisation, the model assumed full FCA when in fact it would take many years to implement as demonstrated by hindsight. Consequently the model was not a true reflection of the reality of the situation.

Finally the Evaluation Matrix (Appendix B) public cost/benefit test used no quantitative or qualitative analysis to justify any of its assessments or weightings. There were no case studies provided from any sources to justify the outcomes.

The public benefit test which was established by KPMG in consultation with local government was selective in the aspects of the National Competition Policy Guidelines for Considering the Public Benefit Under NCP (March 1997) or the Public Benefit Test for Corporatisation of Local Government Trading Enterprises (Nov 1998) which it used.

Instead KPMG developed the evaluation criteria subjectively (see page 15) "The evaluation criteria and sub criteria that have been developed in conjunction with Council".

The potential revenue from CSO (community outcomes) together with the service delivery benefits which could be achieved from greater accountability would have provided substantial benefits to local government and water users. The importance of CSO's was not understood and their potential value limited in the evaluation process. This is demonstrated by local government still not identifying CSO's.

Furthermore the PBT underestimated the potential savings (financial outcomes) from contracting for services and being corporatised as the local government did not correctly state the facts (ie Civic Solutions HCC) (page 8). It stated this unit was corporatised when in fact it was not and there is no contracting or competitive tendering of services between the business units. Effectively all the staff which operate the water and sewerage business are allocated to Civic Solutions and consequently the head counts and potential savings from competitive tendering was reduced as the water business showed only 12.5 employees instead of over 60.

The assumption that FCA reform would continue (and given hindsight) demonstrates that the assumptions of governance (governance outcome) was clearly underestimated and the reluctance of local government to effect change and meet its commitments as specified was not taken into consideration in the evaluation.

The KPMG report and analysis are almost identical for Northern Midlands Council and Hobart City Council, yet the difference in their size and operation are like "chalk and cheese". In fact the discourse in some areas are the same yet the weighted score is different. (See Appendix 2 in item 5 and 6)

(b) External Assessment

The external review of the Corporatisation Public Benefit Test was under the control of the Local Government Association of Tasmania (LGAT) see letter dated 25/3/99 (see item 7)).

This letter stated that:

"The constitution of the review group will comprise a representative from a council larger than the council being reviewed, one from a council smaller and a representative of the council being reviewed".

It is submitted that the peer group as constituted, lacked independence and objectivity. We believe this peer group composition confirms our argument that the process was compromised. We believe if an objective assessment was undertaken the outcomes would have been significantly different.

Summary

We believe that to deal with water and waste water issues successfully in Tasmania there has to be institutional reform and the fewer levels of government involved the better. Local Government should not be involved in water or waste water management. It should all be merged into one or three water authorities including the bulk water authorities. These authorities would then be regulated through GPOC as well as the State. The Commonwealth could then regulate material water issues more effectively if this structure was in place .

The fragmented nature of the industry in Tasmania and the competing political issues in Tasmania at Local Government level means that at present water and the water industry is not well protected. The Commonwealth needs to take a more active had in protecting water and the environment. The NCC was a start but unfortunately much of there positive initiatives have been circumvented. There needs to b a phase 2 plan by the Commonwealth to complete much of the work started by the NCC

We hope this submission is of some value and if you desire for us to appear before the committee it would be an absolute pleasure.

Yours truly


Robert Rockefeller

ADDITIONAL INFORMATION HELD BY THE SECRETARIAT

Attachments to Submission No. 139 - Nekon Pty. Ltd.

1. Water Consumption -Volume of Water Consumed per Residential Property 1999/2000.
2. Measuring Council Performance in Tasmania 2000 - 2001.
3. Water Sewerage and Drainage Review Tasmanian Roles and Functions Committee Final report. A report by London Economics for the Tasmanian Roles and Functions Committee, September 1995.
4. Devonport City Council - Rates
5. Hobart City Council - Corporatisation Public Benefit Test. KPMG Management Consulting March 1999.
6. Northern Midlands Council - Corporatisation Public Benefit Test. KPMG Management Consulting March 1999.
7. Local Government Association of Tasmania re: Peer Group Review - Public Benefits Test.