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Ms Deborah Cope
Acting Executive Director
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GPO Box 250B
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2nd April 2003

Dear Ms Cope

Submission on Tasmania's Water Reform Progress for The 2003 National Competition Policy Assessment .

In preparing our submission for the National Competition Council("NCC") review into Tasmania's water reform progress for the National Competition Policy Assessment 2003 we thought it would be appropriate to analyse all of the rating and charging systems (general rates as well as water , wastewater and waste management) for all the major local councils in Tasmania .

The Current Pricing Regime in Tasmania for Water and Wastewater

It is important to have the real facts before reviewing and commenting on the pricing regime in Tasmania for water and wastewater and not distilled information which does not show what is really happening .The attached colour chart compares all the current rates, taxes and service charges for all the major Councils in Tasmania. The chart also focuses on whether Councils have implemented two part tariff pricing for water and if they are actually pricing their water and sewerage services correctly.

There is no point Councils or the State claiming to have two part tariff pricing for water when in fact they do not. We believe many Councils are in fact rorting the system as this chart would tend to indicate. The Councils which have not implemented two part tariff pricing or do not have meters are generally the largest Councils by population in Tasmania. These Councils should in fact be setting an example. These issues have previously been discussed in earlier submissions where we found councils manipulated the findings of studies into corporatisation and two part tariff pricing.

We have colour coded the various Councils into three categories. Those Councils which do not have water meters, those which have water meters and have not implemented two part tariff pricing correctly and those which have implemented it correctly. The results are as follows:

Yellow is for Councils which do not have water meters or two part tariff pricing. These councils which are generally in the South should have water

meters but this is another issue. However the quantum of AAV (“property based pricing”) rate for water and sewerage as well as storm water should be carefully examined. These numbers like for the councils in orange adjust the AAV rate for water and sewerage to meet the urban pricing guidelines. What sort of regulatory system is this where the rates are changed just to meet some guidelines yet the net effect stays the same. The urban pricing guidelines in Tasmania are a sham.

Orange is for Councils which claim to have a two part tariff pricing system for water but really do not and are rorting the system. This is evident by them still charging by the AAV method for water and sewerage services(ie the fixed component) or alternatively having a high minimum water allocation and a low price for excess water . In many cases it is a combination of both and the water allocation is so high it rarely is incurred. We believe in many cases councils are not even reading the meters.

Green is for Councils who we believe have implemented two part tariff pricing for water and sewerage correctly and should be congratulated(some still have AAV charges but it is generally minimal). While we could argue that volumetric pricing could be introduced for sewerage(as what occurs in many places in Australia) and effectively reduce the fixed charges for low water and sewerage users .These Councils are still a long way ahead of the Councils marked in Yellow and Orange.

This chart will be the basis for our submission and we will be referring to it throughout.

Institutional Problems in Tasmania

In preparing our submission for the NCC we thought it appropriate to obtain an overview of the institutional problems with the entire process in Tasmania

1.Retailing of Water and Wastewater in Tasmania

In Tasmania local councils own and operate the retailing and reticulation of water and wastewater. There is no institutional separation of these activities between water authorities and councils like in most States of Australia. This fundamental lack of separation results in no “ring fencing” of these activities with the consequences that the pricing and investment or lack of it , in water and waste water assets is manipulated by local councils.

2.Regulation in Tasmania

As you are no doubt aware there are 3 bulk water suppliers in Tasmania. These are Esk, North West and Hobart Water. The bulk water suppliers are owned by the retailers which are the local councils in their area. This is a significant conflict of interest. The regulator being the Government Pricings Oversight Commission (“GPOC”) regulates the wholesale price of water but

no one regulates the retail price of water. This results in ineffective regulation. Everywhere in the modern western world the regulator is suppose to regulate the retail price of the product. **There is no Gatekeeper.** What is the point of having a two part pricing system for bulk suppliers and not retailers?

3.Enforcement

The State Government has produced a number of guidelines over the years on National Competition Principles("NCP") such as Community Service Obligations("CSO"), Urban Water Pricing ("UP") and Full Cost Attribution("FCA") however the State does not have any enforcement provisions attached to those guidelines unlike Government Business Enterprises("GBE") which they control. Consequently many local councils have failed to implement the guidelines because they are aware of the lack of enforcement. There are many examples we could use to demonstrate this point.

4.Size

In Tasmania, there is a significant range in the size and activities of local government. The largest Council has a population of over 60,000 people and a turnover in excess of \$60 million. While the smallest has a population of around 950 people and a turnover of around \$2 million. It is important that the NCC does not govern for the lowest possible denominators but instead the highest. The large and medium councils represent 86% of the population and about 83% of revenue yet only represent 56% of Councils. However our analysis shows that the worst offenders in not implementing water reform or NCP is the larger councils(top 6 in terms of size) .

Local Government and the retailing of water and wastewater is dominated generally by a lack of scale. As we are all aware this is one area where scale can bring enormous benefit to consumers and the environment. When opportunities or studies have recommended the merging the wholesalers and the retailers such as the London Economics 1995 Report (a copy of the summary report is attached) which demonstrated the potential benefits, local councils fought aggressively to defeat the proposals. Many would argue that if changes as recommended in this report were implemented most of the issues such as cross subsidies, metering, CSO, proper pricing for water, valuation of assets , reinvestment into infrastructure, dividend policies, ringfencing and an effective regulatory environment would not exist.

Review of National Competition Council Assessment into Tasmanian Water Reform Chapter 7 2002 Outstanding Issues

We have reviewed the 2002 Tasmanian Assessment into Water Reform Chapter 7 and herewith provide a number of comments some of which will also be elaborated later when discussing the 2003 Assessment Framework.

1.Full Cost Recovery:Urban

The statement on page 7.6 that “To address the under-recovery of costs by Hobart water and wastewater businesses, the Hobart City Council(“HCC”), in consultation with the Tasmanian Government, developed a full cost plan. Tasmania advises that the HCC’s water supply and wastewater businesses will operate on a full cost recovery basis from 2002-03.This approach will be achieved by re-allocating Hobart’s rate revenue from general rates to water and wastewater service undertakings”

This statement summarises our arguments regarding full cost recovery.The urban pricing guidelines and their implementation are an absolute sham and offer no protection to the public. Because of the lack of ringfencing and the refusal of the State Government to enforce it, for the water and wastewater businesses of councils, many councils in an effort to meet the urban pricing guidelines just manipulate their rating structure to achieve the result for example changing from general rates to water or wastewater service rates.

This is just a form of creative accounting at best. In a corporate world some would claim it is fraud. The funds from the water and sewerage businesses are just used for general operations. Most cities do not operate separate profit and loss accounts or balance sheets for their water and sewerage businesses. Meeting the urban pricing guidelines through this type of manipulation cannot be allowed. It is particularly frightening when they actual admit to it as above.

The statement on page 7.6 “Tasmania has also stated that climatic conditions over the reporting period have led to a lower level of cost recovery in some local governments, and that this should fall should be reversed in coming years”

This statement is a fallacy. The reason is that many councils use AAV for the pricing of water and do not have a proper user pays system. Consequently climatic conditions will determine how much water is used(ie purchased from the bulk retailer) not how much is charged to the consumer. Generally there is plenty of water in Tasmania no matter what the weather conditions therefore people should be able to use and pay for it. This would not have an impact on cost recovery.

On page 7.7 it states “The Council is looking for jurisdiction to demonstrate that they have processes in place that will continue to achieve the objectives of the water reform beyond the life of the Council’s assessment”

Unfortunately GPOC does not have any enforcement provisions and are effectively a “toothless tiger”. It is imperative that GPOC is given enforcement provisions by the State to enable water reform to be completed beyond the life of the Councils assessment framework as much work is left to be done in Tasmania.

Consumption-based pricing

On page 7.10 the statement is made "For 2002, Tasmania has reported significant progress in this area of reform with 17 of the 18 schemes now having implemented two-part tariffs, in line with targets. The remaining scheme, operated by Derwent Valley Council, was to commence two part tariffs in July 2002"

As has been illustrated from the attached colour chart already discussed this statement has absolutely no basis.

In addition most councils do not have an effective trade waste regime like in mainland States which are operated as part of the sewerage system by the water authorities. Most councils in Tasmania have just implemented a trade waste policy with only a few of their major users. It is very limited and basic.

On page 7.13 a statement was made which said "Hobart City Council has released a water reform package which is directly related to COAG water reform commitments, and appears to address some of the issues raised in the submission by Mr Rockefeller. In relation to consumption based pricing, HCC have committed to undertake the following measures:

Installation of meters for all non residential customers

Application of a two part tariff system of charging when non residential metering is complete; and

To attribute costs internally. Units responsible for the management of water use by HCC properties will be charged for that use in a transparent manner."

We have tried to establish who actually made this commitment. Please find attached correspondence from the Hobart City Council refuting they made such a commitment. Please advise if the State made this commitment in response to this submission or the NCC. We are very concerned that commitments are made yet no one follows up to see if they have been implemented. It is evident from our research that the HCC has effectively "mouth balled" the water reform package.

Community service obligations

On page 7.33 and 7.34 the following statements were made "At that time, almost all local governments reported having no CSO. Tasmanian noted that this issue would be addressed as part of the audit by the commission." In addition "The commission's most recent audit did not address community service obligations and the Council is not aware of whether Tasmania plans to review or make transparent local governments' compliance with the above requirements"

This issue continues and Tasmania fails to address it. The lack of charging for local governments own water usage for example has a significant impact on the urban pricing water guidelines. We estimate that if local governments charged their own occupation of building on an AAV basis as income as well as usage for areas like parks and gardens that the water and sewerage businesses would have additional income of between 5 to 10 %. Guidelines

have been set down by the State for many years but no one is enforcing the implementation. Many councils do not even have water meters so how can they comply. This is how they get around complying. The less they do the less chance they have of not having to comply. They are effectively using "guerrilla tactics" and believe it is a war of attrition knowing that the NCC Assessment Framework concludes in 2 years.

Cross-Subsidies

The statement on page 7.35 says "Tasmania has not undertaken an open and transparent analysis to identify levels of cross-subsidisation. The establishment of a more open and transparent price setting process, however, could address the Council's concerns about the transparency of cross-subsidies"

It is clear from the attached letter from GPOC the lack of identification of cross subsidies will continue. Some would argue that there is absolutely no will in Tasmania to tackle these issues. The current service charging regime in most councils is a cover up for taxation. Theoretically a service charge should be for a service and charged on a user pays basis. The lack of identification of cross subsidies demonstrates that councils and GPOC do not have the intent to meet NCP.

Institutional reform: structural separation

On page 7.43 the following statement is made "Tasmania has not provided the Council with any further information on what mechanisms it is considering for improving the transparency of pricing, CSO and cross-subsidy information, when a proposal was taken to the Treasurer or when it will be implemented. To the Council's knowledge, there has been no progress on this issue"

We believe this statements summarise the underlying issues of water reform in Tasmania. Until there is institutional reform and structural separation such as that recommended in the London Economics Report water reform and that any benefits will be lost to Tasmania. The NCC must make a stand!

The bulk water suppliers are owned by the retailers which are the local council. The regulator being the Government Pricings Oversight Commission ("GPOC") regulates the wholesale price of water but no one regulates the retail price of water. This results in ineffective regulation. Everywhere in the modern western world the regulator is suppose to regulate the retail price of the product. There is no Gatekeeper.

The 2003 NCP Assessment

Many of the issues in the 2003 Assessment were in the 2002 Assessment on water however we have tried to discuss and outline other issues which are linked but also keep within the same outline

Full cost recovery:urban

Firstly we draw your attention to the following principles which were adopted in developing the urban water pricing guidelines by local governments in Tasmania for the audit into local councils water pricing by GPOC. These were

1. Water services should be financially independent.
2. Water pricing arrangements should be transparent.
3. Prices should be cost reflective.
4. Prices should provide a mechanism for users to have input into their level of service.
5. Cross subsidies should be eliminated.
6. Water pricing arrangements should contribute to environmentally sustainable outcomes.
7. Where it has been shown to be cost effective to introduce two part tariffs. It should be.

It is our opinion any audit must measure against this criteria. We believe most local councils in Tasmania particularly in Southern Tasmania would failure most of these principles. Yet why have these principles not been used in the audit. Some may argue that the State is manipulating the outcomes by the method they use for the audit. We submit the current method does not meet National Competition Principles ("NCP") or NCC requirements or COAG.

The following are some of the reasons we believe the previous audit guidelines and audits were defective. We particularly analysis the last GPOC audit for 2000/01.

1. The cities change around their accounting to meet the urban pricing guidelines. The audit numbers from various cities make no sense for example compare the operation and maintenance costs as well as the administration and overhead costs between Glenorchy and Hobart for water and also sewerage. You can see very quickly they are a nonsense. It is a blatant fabrication. We believe in doing the audit for the urban pricing

guidelines GPOC should analysis the operating plans and internal budgets of the Local Governments and not the annual reports as these documents are an attempt to manipulate results for accounting purposes. GPOC should be analysing comparables between cities and then assessing whether the numbers provided by cities are accurate.

2. Most water and sewerage businesses of the Local Governments we have studied are not ring fenced. Whether they use two part pricing or not they should be ring fenced. They should have separate Balance Sheets and Profit and Loss statements for these businesses. They do not. They take revenue to general revenue. If this occurs it should show up as an inter business loan.

This is what NCP are all about. Take Hobart City Council ("HCC") as an example in the operating plan for 2002/03 they do not even separate the rate. They do not allocate the service rates to the business units. Therefore it is obvious there are not ring fenced or treated as separate business units and the rates are being manipulated to only meet the urban pricing guidelines. It is obvious. GPOC must get behind the numbers and report what is really happening. GPOC owes a duty of responsibility to all ratepayers, citizens and customers of water and sewerage services in Tasmania. Local Government knows better and they are taking advantage of the situation.

3. CSOs should be recognised and if not estimated. This also applies to waste water. It should be paid for from the general rate. CSOs can be easily estimated. This is effectively stealing from the water and wastewater business by not allocating the funds to these businesses. This is just another example that the businesses should be ring fenced and monies entitled to the water and wastewater businesses are being used for other council activities. Another example is that Southern Tasmania usually has water restrictions each year drought or no drought. The reason for this is because there is not sufficient infrastructure or alternatively not water meters to mitigate demand. If the monies were quarantined or for water and wastewater usage then infrastructure would be developed to overcome shortages in summer even though there is plenty of water available from the bulk water supplier or alternatively meters would be installed to regulate demand.

4. Leakage should be estimated. We believe it is at least 30% where there are no meters. This is supported by interstate reports. Leakage should be paid for from the general rate as it is because Local Government makes a political decision not to have meters and therefore it is a general rate. Almost like a CSO. GPOC should state how bad leakage really is. If the public new how wasteful local government was regarding leakage they may do something about the problem. At least the public would be informed.

5. What about the proper pricing of water. Some analysis on this should occur, to see if it is correct. We will give you 2 example at how cities do not price water correctly. In Hobart the 2 major users being Cascade and the National Foods use a similar amount of water every year yet they only get charge at the marginal cost of water. They do not pay for any of the overheads/fixed costs. This pricing policy is unacceptable. It needs to be challenged and fixed.

Another example is local government in the north of the state with two part pricing, they keep on decreasing the volumetric price of water while increasing the fixed price of water so as not to over charge high water users and face a political backlash from high water users. Another example of pricing for water which is unacceptable. GPOC should investigate this as part of their audit.

6. What about the recognition of cross subsidies between residential and non residential users. This could be easily estimated.

In summary all of the above issues are about meeting the principles of the urban pricing guidelines as well as COAG and the NCP principles. Yet none of them are currently being audited. The previous audit process failed to examine these important issues. In addition because there is no ringfencing it is impossible to tell what the dividend is the local councils are taking from the water and sewerage businesses. We believe it is substantial. Obviously if it they were separate authorities the dividends policies would be transparent even though they may not be justified. At present in Tasmania there is no way of telling and the current audit being undertaken confirms our concerns. Please see letter from GPOC dated confirming this position.

We attach a letter we sent to GPOC dated the 7th March 2003 analysing the previous audit and issues which needed to be focused on. It is time that the audit process went behind the rubbery numbers submitted by many Local Governments

Consumption based pricing: urban

The attached colour chart which has previously been discussed clearly shows that most councils in Tasmania still use property based valuations to charge for water and wastewater. Many councils which claim to be using a two part tariff pricing regime is a fabrication. It is clear from the attached chart that these councils have manipulated the system intentionally and have done everything to stop consumption based pricing including establishing free water allowances.

It is evident that the low water users are still subsidising the high water users and that there is probably a high degree of subsidisation between various classes of users. There is significant nontransparent cross subsidies throughout most councils in Tasmania. We believe from analysis of comparing general rates and service rates between Tasmania and the mainland and the method they use to calculate rates (ie AAV) there is a significant disincentive to property investment and development in the State. Our own analysis and experience is the same for wastewater. We have done analysis on this matter and would be happy to share it with the NCC if requested.

Community Service Obligations (CSOs)

All local councils in Tasmania SBAs (ie water and sewerage) or Business Activities have failed to identify CSOs or implement the FCA or CNP principles and guidelines which have been articulated since 1997. A specific document on CSOs in November 2000 has still not had any impact on most local councils in Tasmania. This has resulted in the revenue for businesses such as water being underestimated (ie no revenue from parks and gardens). This has resulted in a larger loss pursuant to CNP, the ability for councils to obtain a higher return than they should be and water users continuing to subsidise ratepayers

The CSO November 2000 document on page 6 states the following regarding implementation

“Council must identify existing CSOs 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 programme for identification and review of CSOs and provide sufficient evidence to demonstrate ongoing compliance with this NCP reform element”.

The NCC Assessment on Implementation June 2001 confirmed our findings when it stated:

“Tasmania has advised that local governments have commenced reporting on their water and wastewater service CSOs to the Department of Premier and Cabinet, as required under the revised Government Prices Oversight Commission Guidelines issued to Councils in April 2001. However, almost all have reported no CSOs to date. Tasmania note that this issue will be addressed as part of the Commission’s audit.”

There should not be a problem in identifying CSOs except a major reluctance particularly for cities which do not have metering such as Hobart and Glenorchy. The Urban Pricing Guidelines states the following on CSOs:

“The reporting format provides for the recognition of the cost of CSOs 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 through 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.”

Another CSO which is never mentioned is the issue of leakage. We would argue that most cities which do not have water meters have leakage of at least 20%. As you are aware world’s best practise is around 10%.

Consequently if councils do not want to invest in water meters it is effectively a CSO as the council has made a decision that the water business should not limit leakage and therefore there water purchases. This is effectively a CSO and the general ratepayers should be funding this extra cost as it is a decision by councils not to meter. We would argue that if the water and sewerage businesses were independently operated that water meters and consumption based pricing would be a given and leakage would be minimised. In addition councils would be charged for their own water use.

Many of these problems can only be resolved through real institutional reform.

Cross-subsidies

There is no doubt that there is significant cross subsidies between low and high water users(both commercial and residential) as well as different classes of property owners. Local councils should be forced to identify the cross subsidies. We have requested from the State, GPOC and some local councils for this to occur. Our requests have been ignored.

Because most councils in Tasmania fail to price water appropriately they are incapable of identifying the cross subsidies. Local councils even fail to price water for excess water users such as large businesses(ie breweries, dairies) who use excess water, year in year out. They continue to price it at the marginal cost of water and effectively fail to charge these large water users any of the fixed costs of water. Because local government does not and continues not to do this type of analysis they fail to identify the cross subsidies.

Unfortunately the work and numbers that GPOC and the Department of Treasury and Finance do as part of their submission for the NCC Assessment is so filtered that the information which is provided is of little value and distorts what is really happening. The State has not used a "stick" to seek compliance from local councils and consequently most have taken advantage of the situation and thumbed their nose at the process.

Institutional separation

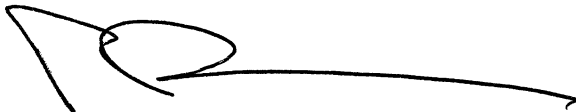
It is our opinion that at the present time there is no institutional separation of water and sewerage and the original goals and objectives of COAG have been defeated in Tasmania. . The potential benefits have been lost to the State because of the parochial nature of local councils and the desire of local councils to keep their empires. There has been no focus on what is in the best interests of ratepayers, the region and Tasmania. As stated we would only be too happy to show you some analysis we have done in this regard. We believe until the NCC gets serious and enforces change in Tasmania their will be no change and local government will continue delaying the implementation of water reform under the NCC Assessment finishes in 2005.

Summary

Water reform and the commitment of local government to the principles of NCP is sadly lacking in Tasmania Fundamental NCC issues are not being addressed because there is not a "big stick". The issues of water reform in Tasmania is significantly different then in most other States because local councils are the retailers of water and sewerage as well as being owners of the bulk water seller. The Rules of Engagement need to be significantly different by the NCC in Tasmania to handle these problems and overcome the structural resistance to change. As was recently quoted to me "Reform Delayed is Reform Denied".

We desperately need the help of the NCC before your involvement ceases in 2005.

Yours truly

A handwritten signature in black ink, consisting of a large, stylized initial 'R' followed by a long, horizontal stroke that tapers to the right.

Robert Rockefeller