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Strategic Management / Econometric Market Analysis - ABN 26 021 850 787

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Urban Water Inquiry
Productivity Commission
LB2 Collins Street East
Melbourne Vic. 3165

Dear Sir/Madam,

Comment on the draft Inquiry Report (the Draft) has been invited and the following is offered:

General Comments

The Draft provides little comfort that correspondence supporting Submissions #7, #9, #25, #59, #80 and #81 have been subject to forensic analysis prior to its publication. The September 2010 Discussion Paper invited public submissions on the subject of governance and institutional arrangements. It is only in Box 3 and pages 288-289 that inability of the Queensland Competition Authority (QCA) to protect households on the Sunshine Coast against monopoly pricing abuse (a legitimacy issue) appears adequately addressed. The discussion of institutions and governance arrangements in Queensland appearing in pages 471-478 neglects to include the Queensland Audit Office (QAO) and the Crime and Misconduct Commission. These institutions do not appear to have been consulted prior to the Draft's publication.

The Draft is silent regarding the complete elimination of transparency for households serviced by Maroochy Water Services (MWS) experienced from 2002/03 onwards, examples of accountability avoidance, failures in integration, and the absence of adaptability by QAO given the information provided in supporting correspondence included with the public submissions cited above. Quotation of a citation from Sydney Water Managing Director relating to monopoly power abuse in Queensland (on page 274) is troubling given information provided in this background correspondence. Quotation of flawed findings relating to determination of legacy regulatory assets and capital recovery from the QCA's draft 2010/11 Prices Monitoring Report (on page 276) is equally troubling following identification of the legitimacy issues spelled out in Box 3. As was the case for a 2004 Inquiry entitled "Review of National Competition Policy Reforms", the Draft neglects consideration of possible rent seeking strategies of government controlled commercial entities and the X-inefficiency/deadweight economic loss consequences stemming from monopoly pricing abuse.

Specific Comments

Page LI's second paragraph requests information relating to ministerial directions to GTEs. Information has already been provided in attachment "N" to submission #7. The last paragraph of page 1 of QTO-09535 and the first paragraph of page 2 describes ministerial intervention preventing both Unitywater and the QCA from performing prices oversight with respect to capital recovery charges embedded in the 2010/11 Budget of that GTE.

The following extract from a public submission relating to the QCA's draft 2010/11 SEQ Prices Monitoring Report – Part B (Submission # 81) is germane:

- *Unitywater has set prices for 2010/11 without performing prices oversight of the 2010/11 RAB mandated by the Queensland Government;*
- *The Minister's QCA terms of reference require the Report to provide transparent information to consumers about the costs (including capital recovery) and other factors underlying the annual increase in water and wastewater prices;*
- *KPMG's discounted flow approach cited by the Treasurer is not available in the public domain nor has the 2010/11 RAB derivation mandated by the Queensland Government been subject to detailed scrutiny by QCA;*
- *Prior period price monitoring reports by QCA have lacked RAB scrutiny and the Treasurer's Office has not provided clarifications requested in correspondence dated 30 July 2010;*
- *Transparency and independent scrutiny with respect to the derivation of The Initial Regulatory Asset Base and 2010/11 RAB is fundamental to providing stakeholder confidence in Unitywater's pricing processes.*

It is noted that the QCA has a regulatory responsibility to have regard to the protection of consumers from abuses of monopoly power (QCA's "Statement of Regulatory Pricing Principles for the Water Sector Section 4.1 page 17). Transparency with respect to the derivation of The Initial Regulatory Asset Base and 2010/11 RAB used by Unitywater to determine capital related charges is essential for QCA to carry out this regulatory responsibility.

This draft's acceptance of an Initial Regulatory Asset Base at 1 July 2008 and the 2010/11 RAB determined by the Minister for Natural Resources without prior performance of independent prices oversight, prevents the Report

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from fulfilling transparency requirements cited above, and prevents the QCA from performing its regulatory responsibilities with respect to consumer protection.

QCA's response to this request is detailed on pages 169-170 of its final SEQ Interim Price Monitoring Report-Part B (March 2011). It confirms the serious legitimacy issues highlighted in Box 3 and on pages 288-289 of the Report that render QCA ineffective with respect to consumer protection.

In response to the information request on page LI concerning whether the Corporations Act 2001 would be appropriate for GTE's; consideration of the ACCC's Competition and Consumer Act (2010) is suggested as an alternative. It would provide urgently needed consumer protection against predatory pricing practices of State Government controlled natural monopoly commercial entities. The failure to detect and qualify audit reports of Maroochy Council, Sunshine Coast Regional Council regarding improper revaluations of MWS assets in 2002/03, 2005/06 and 2007/08 and the absence of qualification of the Board's adopted income valuation approach appearing in SEQwater's 2009/10 Annual Report by QAO demonstrates a need for the strongest possible legislation to protect consumers in SEQ.

The final two paragraphs of Draft Recommendation 11.4 (page LII) are disputed. Correspondence accompanying submissions # 7, #9, #25, #80 and #81 make obvious that good governance has not been embraced in SEQ. The QCA is rendered ineffective with respect to consumer protection due to conflicting objectives. A suggestion that the Queensland Government would initiate an independent review to determine whether its fully owned and/or controlled water utilities are abusing their market power is naïve given the sorry history already provided to the Inquiry. Provisions of Queensland Local Government Act do not address the conflict of interest that is present for an unethical council to use a GTE that is also a natural monopoly as a revenue raising entity irrespective of efficient costs, and its responsibility to perform price oversight over that same entity. Failure to mandate transparency as far as financial performance has lead to improper use of transfer mechanisms for costs and assets that impede the efficiency gains contemplated under NCP for both the GTE (MWS) and those elements of the former Maroochy Council's activities not subject to commercialisation.

Page LIV requests further information on scale economies in the urban water sector. Detailed benchmarking analyses for 2000/01 for Sunshine Coast water utilities and Caboolture have already been provided. Benchmarking for 1999/00 can be found in MWS Advisory Board (MWSAB) Reports of 8 March 2001 and 31 May 2001 confirming apparent absence of economies of scale.

Page LVI again suggests GTE's be structured under the Corporations Act. For reasons outlined on the information request on page LI, adoption of the Competition and Consumer Act (2010) is preferable.

Benchmarking performed by the MWS Advisory Board (MWSAB) for water and waste-water utilities in SEQ does not support aggregation endorsed in Recommendation 13.1. Economies of scale are not evident in benchmarking performed by MWSAB and in the case of the Sunshine Coast Regional Council and Unitywater aggregation has eliminated all possibility of meaningful benchmarking transparency.

Finally, the Draft is silent regarding the problem of Queensland's commitment under National Water Initiative (NWI) Pricing Principle agreements to refund revenues collected that are in excess of legitimate maximum allowable revenues (MAR) and a situation where that MAR has been artificially predetermined by the Queensland Government using legacy regulatory asset determinations that do not comply with the Optimized Deprival Value methodology mandated under these same principles. Such an omission fails to demonstrate concern for households in SEQ suffering predatory pricing abuse as a direct consequence of the litany of governance failures already provided with supporting correspondence.

Yours sincerely,

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