Productivity Commission 2011, *Australia's Urban Water Sector*

Draft Report.

Comments with relevance to the Queensland Urban Water Industry

Background

The Queensland Water Directorate (***qldwater***) is a membership-driven organisation for the urban water industry in Queensland. Over 90% of Queensland local government urban water utilities in SEQ and regional Queensland. ***qldwater*** aims to strengthen the urban water industry to maintain and improve the safety, health, wellbeing and sustainability of Queensland's communities. The Directorate actively promotes collaboration and development across the industry and works through providing coordination, consistent advice and collective input into policy formulation in close partnership with the Local Government Association of Queensland (LGAQ).

qldwater provided initial comments to the PC Inquiry in partnership with LGAQ. The following comments are providedon the Draft Report to reflect communication across the local government urban water industry. These comments are provided to be read in conjunction with support of the LGAQ submission.

The Commission should be congratulated on a comprehensive and robust review of the national water industry. It is clear that consultation has been broad and a meaningful effort has been made to respond to inputs from stakeholders. This review differs from previous (and concurrent) national reviews in the diligence applied to understanding the needs of the diverse Queensland urban water industry.

In general, the comments and concerns of the Queensland urban water industry have been well captured in the Draft Report, even in controversial areas, and significantrecommendations reflect the need for fit-for-purpose responses to this diverse sector. Specific queries and further industry information are listed below along with some general comments. All page references refer to the Microsoft Word version of the Draft Report available from the PC website at www.pc.gov.au/projects/inquiry/urban-water.

General Comments

One general concern with the broad recommendations in the Draft Report is that they are holistic and interdependent. For example, may of the pricing reforms rely on equivalent reforms in taxation and transfer payments to ensure equity and affordability of supply.It is likely that jurisdictions will be slow to implement some changes, while others may be adopted relatively rapidly. This could lead to inefficiencies.

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Importantly, the potential structural reforms for the metro (Chapter 12) and regional (Chapter 13) segments of the industry rely on many precursor reforms to be effective. This is recognised in the Draft Report (p. 326):

> *The analysis contained in chapters 12 and 13 assumes that all of the universally applicable reforms set out in chapter 11 have been implemented, and that property rights to water, wastewater, stormwater and recycled water products have been clarified (chapter 6).*

This should perhaps be emphasised further.The risk of ad hoc restructuring is a real one and the report should further highlight the need for holistic reform rather than merely restructuring the water utilities themselves. For example on page 383 it is noted:

> *"it is important to remember that structural reform is not the only way that efficiencies can be achieved in the regional water sector, and in most cases, pressing ahead with structural reform in isolation of other reforms will be ineffective."*

qldwater strongly endorses this comment and suggests that this message be emphasised earlier in the report to avoid reactive or ad hoc reform as has occurred in the past (see point 1, below).

Specific Comments

Chapter 1

1. Drivers of change and inefficiencies.

On pp 2-3 the Report finds that "Although considerable reform has occurred over the past three decades, the urban water sector has been under stress in recent times." The stresses listed are:

- "a lengthy period of unexpected low rainfall and inflows"
- "heavy rain and floods in eastern Australia"
- "pressures from growth in demand,
- "ageing assets and reduced capacity to supply from existing rainfall dependent sources"
- "water quality problems [……] in some regional areas"

It is suggested that some of these stresses have led to "prolonged use of severe water restrictions and consumption targets", the "use of mandated measures or subsidies to reduce the consumption" and "large investments in rain independent supply augmentation". It is concluded that these "recent experiences in the sector have created further impetus for this inquiry".

Notwithstanding the reality of this summary of stresses and responses, this section misses a key point in the analysis of the industry namely: **the major cause for recent inefficiencies in the urban water industry are the cyclical and ad hoc responses to**

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accommodate recurring or predictable stresses. Although some of the responses listed are unprecedented in magnitude, they are oftenmerely extensions of common industry solutions. It is the timing, urgency and unplanned nature of these responses that have resulted in a range of sometimes very costly inefficiencies

Most of the stresses listed are common and not only recent, but also recurrent and ongoing. Planning for droughts, floods, increasing demand and ageing assets are standard processes in any well-managed water business. Inappropriate or inadequate responses to foreseeable stresses should be unacceptable, but often reflects the constraints of a politically motivated and reactive governing framework for the urban water industry.

Rushed and reactive responses of unprecedented magnitude suggest panicked rather than deliberative decision making and inevitably result in inefficiencies. By overtlyrecognising this underlying issue for the urban water industry, this Inquiry could avoid reinforcing the cycle of heavy investment followed by general disregard for the industry that has been common in the past.

2. Regional View of Water and other Essential Services

On p. 5 it is recognised that "water is often perceived to be different from other utility services (electricity, gas, telecommunications and mail) because water is 'essential for life'". However, the Report aims to de-politicise the issue of water supply by "adopting the same approach as it would when considering other utilities that also provide 'essential services', [in order to] arrive at policy advice that deals with the challenges and legitimate concerns of the community in both country and metropolitan areas." This is a sensible approach but misses an important point about water as an essential service.

In regional Queensland, electricity, communications and road services are viewed along with water as essential services for small and remote communities. As in other states, some these services have often been developed primarily through the action of local communities (often with Commonwealth and/or State assistance) so there is a strong sense of 'ownership' in their provision and historical management. This perception grounded deeply in the culture of many wester communities.

Further water is seen as different from the other utilities, not only because it is "essential for life", but for two important additional reasons.First, when other services are unavailable from time to time (e.g. when areas with seasonal flooding are routinely isolated), they can be substituted or done without for some time. In contrast, water services to urban areas are difficult to replace for any length of time. This places a premium on reliant and self-managed water services in remote communities and also complicates the cultural 'ownership' of water infrastructure and its management.

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Second, water is generally the first essential 'service' to have been developed and indeed often forms the basis and defines the location of remote communities. Although modern services have developed on top of original water supplies, there are strong local links with historical and cultural dimensionsfor water supplies in remote (and particularly indigenous) communities.

This cultural and practical complexity means that water services are viewed differently from other utilities. There is significant concern among small and particularly remote communities that increased centralisation of decision making about water and wastewater services will further distance them from decision making processes (see also Comment 56 below). Further, there is a real concern that even their basic needs could be overlooked in favour of larger communities. This (real or perceived) risk is tolerable with many services but unacceptable for water supply. Treating water as akin to any other essential services is appropriate in many respects but does not align well with perceptions in regional Queensland with its numerous remote communities.

Chapter 2

3. Inclusion of stormwater in the scope of the urban industry

The scope of the urban water industry is described on pp 10-11(and elsewhere) as including potable water, wastewater and stormwater components. ***qldwater*** supports this definition on the grounds of best practice in whole-of-water cycle management but it should be clear that in many places stormwater is managed separately from the potable and wastewater elements of the industry.

This issue is recognised in the Draft Report. For example Table 2.16 on page 48 shows that stormwater is often managed by local governments in many jurisdictions. Chapter 12 further distinguishes the differentiation of the stormwater industry.

Even in Queensland where local government manages all elements of urban water, there is a fundamental (though perhaps artificial) divide between stormwater and potable and waste water management. This should be acknowledged in this chapter of the Report because of the resultant complexity of any ongoing discussions of integration of these three elements.

4. Definition of recycled water and wastewater treatment processes.

On pp 12-13, Box 2.1 and 2.2 give definitions for different classes of recycled water and also for standards of wastewater treatment. These definitions are routinely subject to technical modification and industry and jurisdictional controversy. Inclusion of such definitions in this high-level review is unnecessary and likely to cause argument rather than clarification. If such definitions must be included, they should at least encompass

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the advanced wastewater treatment that occurs in South East Queensland which is treated to a standard that exceeds 'Class A' recycled water and is ostensibly suitable for potable reuse.

5. Direct potable reuse

The controversial and political nature of potable reuse of wastewater means that messages must be very clear. On page 13 the Report states that "in Australia recycled wastewater and stormwater has been kept separate from the potable water supply" with a few exceptions. It then goes on to claim that "**This however, is not the case in other countries**" and specifically site the case of Singapore where "recycled water meets 30 per cent of Singapore's water demand". This statement may be seen as misleading given the paucity of other examples of cities where direct potable reuse is common practice.

6. Breakdown of water and wastewater supply chain costs

The breakdown of the components of water and waste water services on pp 14-15 is useful but fails to mention economies of scale. An extra dot point should be added to express the fact that costs will be highly affected by large capital expenditures in small communities. This is important to later arguments for/against economies of scale, and cross-subsidisation of small communities (see e.g. Comment 56 below).

7. Cost of supply of bulk water

On page 15 it is noted that the "operating costs of bulk water supply could be expected to rise in coming years. This is due to new supply augmentation options, such as desalination, having relatively high operating costs, compared with traditional supply sources such as dams." Although technically correct, these statements gloss over a wide range of diversity relevant to regional urbane areas.

First, although the cost of desalination is higher than sourcing water from dams, this cost is confounded with the costs of treating the water. In desalination plants, these sourcing and treatment occur in the same process.

Secondly, the statement also ignores the fact that desalination is unlikely in most regional areas, even in large coastal centres. In these urban areas costs are likely to increase due to increased water security measures and increasing water quality requirements and standards.

Finally, many regional towns source water from artesian bores. In these towns the cost of supply is not likely to increase as demand remains relatively constant. These towns may be insulated even from costs of increasing water quality standards if the water source is of good drinking quality. However, in some areas additional treatment may be required to meet standards for total dissolved salts and aesthetic standards. ***qldwater***

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acknowledges the necessity of focus the examples in the Report on the large metro areas of Australia particularly acknowledging that it is difficult to get data from (say) regional Queensland, but some of the regional supply options need to be recognised in this section as the generic findings do not translate to non-metro urban areas.

8. Energy Costs

Figure 2.2 cites a very high cost for water treatment in Brisbane, but not the Gold Coast. Does this data include the costs of the advanced waste water treatment plants and desalination schemes? This could also explain the disproportionately high cost of water treatment in Perth. If so this data is confounded with the connections created through the SEQ water grid and by the timing of roll-out of desalination plants in major urban centres and should not be taken a generic case study of the broader water industry in any jurisdiction.

9. Summary of Urban supply and service arrangements.

Table 2.16 contains some errors in the information supplied for Queensland, namely:

- "Queensland Water Utilities" should be "Queensland Urban Utilities",
- 'Bulk Supply' column should also include "Linkwater" and "Two Category 1 Water Boards" (namely Gladstone Area Water Board and Mt Isa Water Board), and "Wide Bay Water" a LG-owned corporation,
- '71 local water utilities' In 'Water Retail' and 'wastewater retail' columns should read "62 local governments, one LG-owned Corporation, and several privately owned service providers", and
- 'Stormwater' column should read "73 Local Governments".

Chapter 3

10. Definition of Water Security

The definition of 'water security' on p. 60 should recognise the need for maintaining environmental flows. That is, water security provides the direct goods and services provided from harvesting water and also the indirect goods and services (including environmental goods and services) provided by environmental flows.

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11. Objectives for the urban water sector

Chapter 3 summarises expected objectives for the urban water sector and concludes that they can primarily be encompassed under a broad objective of economic efficiency. Hence Draft Recommendation 3.1is:

> *The Australian, State and Territory Governments should articulate a common objective for the urban water sector in relevant policy documents along the following lines:*
>
> - *The primary objective of the sector is to provide water, wastewater and stormwater services in an economically efficient manner so as to maximise net benefits to the community.*
>
> *Economic efficiency should be defined broadly to include environmental, health and other costs and benefits that might not be priced in markets.*

The objectives included within this broad heading are listed in detail. In general these objectives align with the first 8 Principles outlined by LGAQ and ***qldwater***(developed by a water industry taskforce – see Appendix 1) to guide reform of the Queensland urban water industry which are treated in turn below.

Principle 1: Efficient and effective service delivery and resource use.

> *Strong agreement with suggested objectives.*

Principle 2: Equitable and transparent water sharing across and between regions.

> *Moderate agreement with suggested objectives. This Principle would likely be endorsed by both the Queensland Taskforce and the Productivity Commission when economic efficiencies were demonstrable (i.e. not solely for equitable water availability).*

Principle 3: Needs of individual communities to remain a vital driver of management, policy and planning.

> *Some agreement with suggested objectives of economic efficiency but with the requirement that individualcommunities'interests not be overlooked emphasised. This is an important point. While broad economic efficiency may not favour equal water services across all small communities, the Queensland Taskforce implies that existing communities should not be ignored on the grounds of efficiency to the greater community. This statement recognises the inequity of negotiating power and isolation of such communities from many decision making processes and poor inclusion of such communities in decisions made about services in the past.*

Principle 4: Management of water businesses needs to deliver returns that allow for appropriate asset renewal with a dividend on assets returned to the community through Local Government (with no cross-subsidisation of other council services).

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Strong agreement with suggested objectives with the addition that any dividends should be returned to the community through local rather than state government given their current role in provision of water services. However, given the low or negative rate of return (see Comment 35 below) of some small service providers, it might be expected that dividends would be small or negative.

Principle 5: No community to be substantially disadvantaged (reasonable price for basic access).

Strong agreement with suggested objectives.

Principle 6: Water planning framework to be consistent across the state.

Strong agreement with suggested objectives. The implication is that broad planning for water supply be undertaken by the State.

Principle 7: Water planning and management needs to be directly linked with statutory and land use planning activities of Local Government.

Strong agreement with suggested objectives.

Principle 8: Long-term sustainable asset management (taking into account, for example, Water Sensitive Urban Design, System Supply Losses, Integrated Water Cycle Management and maximising the benefits of vertical integration).

Agreement with suggested objectives. These objectives indicate the need for efficient management of assets for economically efficient service and sustainable management (through integrated water cycle management which includes stormwater). The Taskforce's principles did not place a strong emphasis on environmental protection likely because it was assumed that this would be a role for the State to set guidelines and standards which would then be met by the industry. This agrees with the Draft Report's suggested objectives but it should be noted that the transparency of decision making and inclusion of the industry in determining appropriate and achievable environmental standards has been poor in the past and needs strong attention particularly to avoid 'lobbying costs'.

The remaining two principles recommended by LGAQ and ***qldwater*** referred to governance structures and are dealt with elsewhere.There are no direct principles aligning with the Report's suggested objectives of involvement in catchment management or flood mitigation. This is likely because of the diversity of involvement with these processes at present in Queensland. Some local governments are involved in these processes but others are not. All councils have responsibilities for managing stormwater, but they are usually undertaken through distinct processes that are not aligned with other water services.There is therefore no clear position on these matters from the Queensland urban water industry.

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Chapter 4

12. Environmental Externalities

The statement on p. 79 that negative externalities (from wastewater disposal) impact downstream recreational users and "others that care about the degradation of the affected environment" is too narrow. Such discharges have the potential to negatively impact the entire community through a broad range of environmental goods and services that are difficult to value but are public goods. Examples include breeding grounds and nursery areas for (commercially) important species and environments such as mangroves which provide a filtering functions in estuaries. The sentence should be changed to reflect the contribution of broader goods and services.

13. Community Benefits and Cross Subsidisation

The section on 'government' involvement does not appear to acknowledge local government ownership and management of the water industry in regional areas. Local government ownership has many benefits but also risks. Benefits include close involvement of communities decisions about their water and wastewater services, local employment and the possibility of dividends returned to local communities. The realisation of these benefits and mitigation of potential risks require clear and transparent processes to avoid negative cross-subsidisation or politically driven, short-term decision making.

qldwater supports with minor modification,**Draft Finding 4.1**:

> ***It is the role of governments (elected representatives) to:***
> - ***set objectives for policy development for urban water and relevant objectives for each agency***
> - ***develop policy frameworks and principles in relation to public health, the environment and service delivery that are consistent with these objectives***
> - ***define property rights for water***
> - ***put in place institutional and governance arrangements for:***
>   - ***public health, environmental and economic regulation relating to water***
>   - ***service delivery of potable water, non potable water, wastewater and stormwater services.***

Modifications suggested are:

1. This Draft Finding appears to be referring to government and elected representatives at a state level and should be modified to distinguish the role of local government elected members.

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2. The finding makes no mention of transparency, public accountability or communication with stakeholders. While this may be assumed, the past lack of transparency across the water sector requires that it be reinforced.

Chapter 5

14. Good regulatory practice.

The Report's findings about the need to make regulation effective and efficient and appropriately resource regulators are sensible and align with the desires of the Queensland urban water industry. There is significant room for improvement in the regulation of the Queensland industry. ***qldwater*** *strongly endorses Draft Recommendation 5.1 (pp 95-96):*

> *Urban water sector regulators should rigorously apply the six principles of good regulatory practice spelt out by the Regulation Taskforce in 2006.*

15. Water Pricing

The Report points out some dis-benefits of setting water prices through political means and concludes with Draft Finding 5.1 (p. 99):

> *Price regulation is not an appropriate mechanism to deal with affordability concerns or to ensure that urban water utilities fully recover costs.*

The dysfunctional nature of the price-setting processes in parts of Queensland is reflected by the recent announcements of additional structural changes in South East Queensland on the grounds of community response to water pricing. Across the state water prices are influenced not only by State Government but also local government politics and policy, creating uncertainty and inefficiencies.

This is demonstrated by the range of water pricing arrangements across the state (see Figure 1). The range in customer bills represents fit-for-purpose pricing but in others it is clear that prices are set at artificially low levels and may not achieve cost recovery for the provision of water services. A similar result could be demonstrated for sewerage billing.

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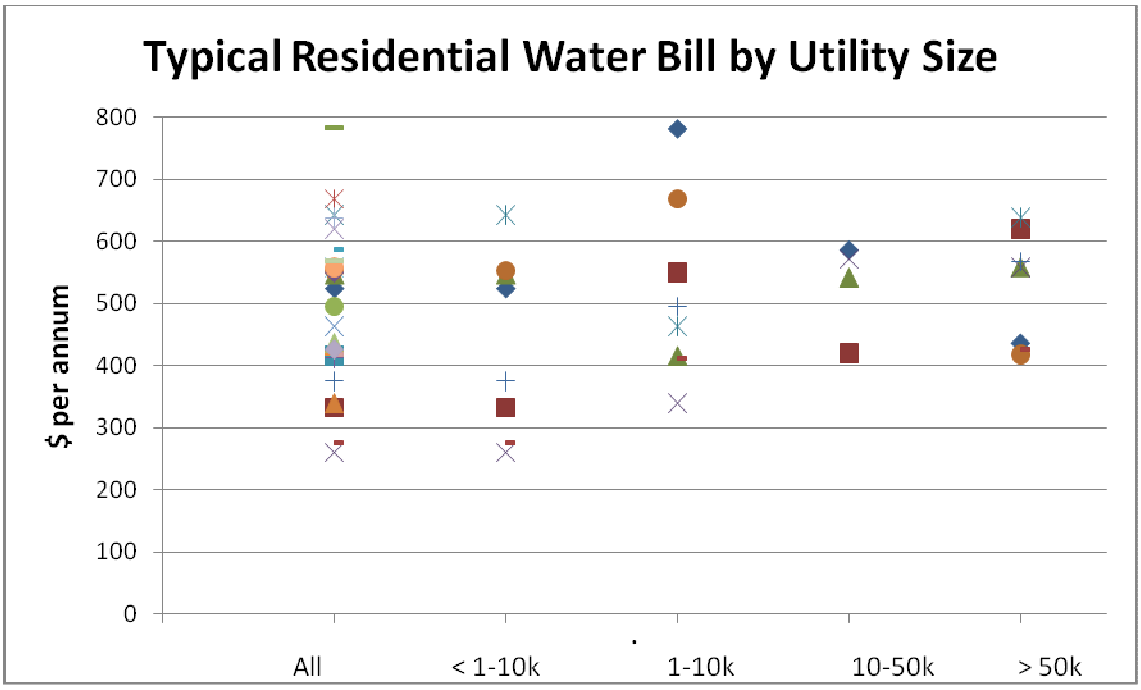

Figure 1. Typical residential water bill (based on average water use) for Queensland utilities grouped by utility size. Source: data submitted by service providers to the State-wide Water Information Management (SWIM) system for the 09/10 reporting period.

A potential benefit of the Queensland system is that price setting can be undertaken on a fit-for-purpose basis across regions, but this benefit may not be realised in many areas because of competing political needs. While ***qldwater*** has no specific concerns with Finding 5.1, in the absence of external price-setting arrangements, the monitoring and checks put in place for the industry need to be stringent and transparent.

Chapter 6

16. Recommendation on balancing supply and demand planning.

qldwater supports Draft Recommendation 6.1 (p. 114):

> *State and Territory Governments should adopt policy settings that allow the costs and benefits of all supply augmentation options to be considered using a real options (or adaptive management) approach.*
>
> *Information on costs, risks and benefits to consumers of all augmentation options should be made publicly available and views of the community sought, especially regarding sensitive options like potable reuse.*
>
> *Bans on particular augmentation options (those explicitly stated and those that are implied by government decisions) should be removed, including those on:*
>
> - *rural–urban trade (to allow water to be allocated to its highest value use)*

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- *planned potable reuse (unplanned potable reuse occurs commonly without any apparent ill-effects).*

17. Recommendation on capital subsidies from State and Commonwealth Governments

With the caveat that exemptions can be granted for specific communities (see Draft Recommendation 13.3 at Comment 58 below) ***qldwater*** supports Draft Recommendation 6.2(p.119):

> *The Australian, State and Territory Governments should not provide subsidies for supply augmentations and other urban water infrastructure, except where:*
>
> - *it directs a utility to invest to produce a particular environmental outcome unrelated to its service delivery responsibilities and the subsidy is commensurate with the costs attributable to achieving the outcome*
> - *a formal process has identified that a particular community should be exempted from the requirement to fully recover costs through water charges (see draft recommendation 13.3).*

18. Impediments to achieving gains from an adaptive approach to supply augmentation

qldwater endorses the statements made by the report on political impediments interfering with adaptive planning for water supply augmentation. On p. 125, the report states:

> *In the Commission's view, the main impediment to realising the gains available from taking a real options approach to supply augmentation is current institutional and governance arrangements. In most jurisdictions these are characterised by:*
>
> - *absence of clarity over the roles and responsibilities of cabinet, ministers, government departments, water utilities and regulators, which can cause delays and uncertainties that erode the benefits available from a real options approach*
> - *political involvement in decision making that can bring with it an undue level of risk aversion and other incentives that work against achieving a least expected cost balancing of supply and demand, as illustrated by the Sydney example discussed above.*

Recent changes proposed for the South East Queensland water industry may provide further unfortunate examples of this disconnect.

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19. Fit-for-purpose Integrated Water Cycle Management

qldwater strongly endorses Draft Finding 6.1:

> *Integrated water cycle management initiatives are often driven by the assumption that increased water reuse and recycling, and decreased reliance on centralised water supply systems are always in the community's interests. A better approach would be to seek to remove impediments to integration (such as the absence of appropriate property rights for wastewater and stormwater and deficiencies in the analyses, and community awareness, of costs and benefits), thereby allowing efficient recycling and reuse projects to be implemented.*

The one-size-fits all policy approach has been an ongoing problem for the Queensland urban water industry with much policy being driven by best practice improvements in south east Queensland. The vast diversity and climatic range of Queensland communities makes implementation of some policies difficult and inefficient in some areas.

One item that the Draft Report appears to overlook when considering changes to property rights and inefficiencies of monopoly management of stormwater and recycled water, are the potential health impacts of poor management. Greywater and recycled water regardless of its source presents a potential health issue not only to direct users but to their neighbours. Part of the inefficiency of centralised systems for managing these potential sources of risks is that there is a clear line of accountability for ensuring the community's safety. Decentralisation and outsourcing must be carefully managed to avoid such risks, potentially in the long term when private companies or subsequent owners of onsite systems become less focussed or forgetful of safety requirements when managing such systems.

20. Scope for efficiency gains in regional areas

Potential for efficiency gains in regional areas is dealt with specifically from p. 145. On p. 146 it is suggested that "it would appear that inefficient asset management is particularly prevalent in some regional areas, due to a shortage of staff with appropriate skills and experience and/or lack of financial resources to undertake asset upgrades."The Report generally recognises the diversity of small regional communities and also that it is difficult to tell if the increased operating costs are due to difficult operating environments or underperformance.

The Report goes on to state that "there is, however, evidence to suggest that substantial efficiency gains could be achieved by some form of amalgamation or alliance between small regional water utilities, which could be combined with governance reforms". The fact that regional Queensland and NSW are serviced by 177 providers while the rest of the country by only 30 is raised as being "striking"

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(p 147). However, the potential for diseconomies of whole-of-state water utilities is also raised.

Finally, the reliance of local governments and their communities on economies provided by local water management are also acknowledged. In general, this section provides is a balanced summary of the factors affecting regional Queensland.

Chapter 7

21. Vertical Integration in Regional Queensland

Bulk water pricing in regional Queensland is discussed on p. 153. It seems to be assumed that water providers outside of south east Queensland are all vertically integrated. In reality the system is more complex, with some providers being vertically integrated, some being supplied by the statutory Authority Sunwater and four communities source bulk water from Water Boards (namely Gladstone Area Water Board and Mount Isa Water Board).

22. Bulk Water Pricing Signals

Section 7.1 outlines the benefits of flexible pricing for bulk water regardless of whether an organisation is vertically integrated) resulting in Draft Finding 7.1:

> *By more closely reflecting the opportunity cost of supply, flexible (scarcity) pricing of bulk water helps to facilitate a more efficient allocation of water resources and more efficient supply augmentation decisions.*

This section does not appear to consider responsiveness of demand. As well as the usual complexities of elasticity associated with utilities and particularly essential services (see e.g. p. 185 of the Report), water demand is strongly affectedby information availability. For example the common practice of 3 monthly (or even 6-12 monthly billing) cycles and a traditional community attitude of being unaware of water prices means a significant change in provision of information from bulk providers to retailers to consumers in order to better manage the risk as of climatically variable water supplies.

There is also an assumption that there can be competition in bulk water supply (see p. 158. In an earlier section the Draft Report comments on the unlikely entry of significant competition into the bulk water market. While small scale operations may be possible (and examples already exist in some states), wide spread bulk competition is impossible, particularly if equity of supply of essential services is a factor (see also Comment 45).

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23. Beneficiary Pays Approach for Recycled Water and Storm Water

The beneficiary pays approach discussed on p. 164 appears to ignore the externalities of recycled water and stormwater reuse. There are benefits accrued to the broader community associated with water savings in times of scarcity, reduced environmental impacts and reduction of the urban environmental footprint.

24. Developer Charges

The Report's findings on developer charges are summarised in Draft Finding 7.2 (p. 171):

> *There appears to be scope for efficiency gains in ensuring that developer charges better reflect the costs of service provision in new developments. Upfront charges should be used where the incremental costs of development are well established and, in the case of urban infill, benefits do not accrue to incumbents. Where the benefits also accrue to incumbents, costs should be spread across all users through rates, taxes or the fixed part of a two-part tariff for water and wastewater.*

qldwater endorses this finding, noting that the recent decision by the Queensland Government to cap development charges may limit the ability to manages such charges in certain situations (e.g. small dwellings) or for high cost developments.

There is a request for further information on development charges on pp. 171-172. Significant input was provided in Queensland to the recent review of development charges which was released at the same time as the Draft Report and may be of interest to the Commission.

25. Metering and direct charges.

The Report acknowledges the need to appropriately assess the costs and benefits of retrofitting meters in (either across unmetered communities or in multi-unit premises) rather than assuming that universal metering in these circumstances will be efficient. Common opinion is that it is unlikely to often be financially viable (at least with current technology) so a cost benefit analysis is essential and with this caveat, ***qldwater*** endorses Draft Recommendation 7.1 (p. 176):

> *Metering technology should be introduced in all new single and multi-unit dwellings. The case for retro-fitting existing single and multi-unit dwellings with separate metering technology should be assessed by utilities*.

and Draft Recommendation 7.2:

> *Utilities should charge tenants directly for all water charges, both fixed and volumetric, where water is separately metered. Where this does not already occur, State and Territory Governments might need to put in place transitional arrangements to ensure that savings to landlords are passed through to tenants.*

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26. Inclining Block Tariffs

Draft Finding 7.3 (p. 180) suggests:

> *The volumetric component of two-part tariffs is currently distorted by inclining block tariffs. Inclining block tariffs lead to inefficiencies and inequities. There are substantial efficiency gains to be achieved from moving to a flat volumetric retail pricing structure.*

Some utilities favour inclining block Tariffs suggesting that they provide affordability. The Draft Report argues against this but relies on affordability issues being addressed through other Government mechanisms.

There is a broad range of tariff structures used by Queensland utilities. Some small providers using Great Artesian Basin bores have free allowances with a single fixed charge, but the majority of providers have a two tiered system (Figure 2). The two tiered systems may have up to three inclining blocks. There is little evidence to suggest that the current structures have a significant impact on water use broadly across the state (see Comment 29 below) though individual utilities report that inclining block structures have been useful in reducing water use in some regions.

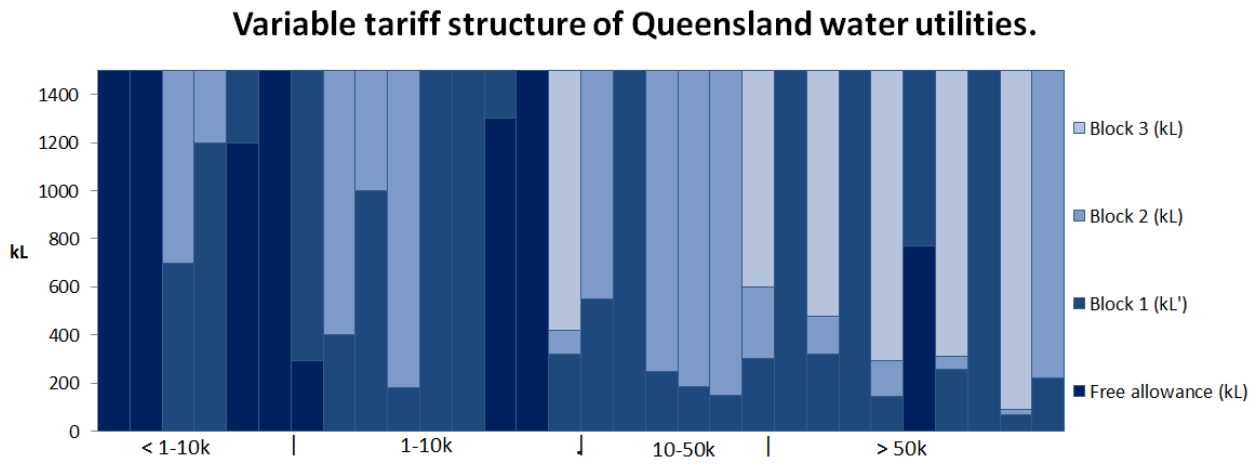

Figure 2. Tariff structure sued by Queensland water utilities includes free allowances, fixed pricing and two-tiered systems with up to three inclining blocks. Source: data submitted by service providers to the State-wide Water Information Management (SWIM) system for the 09/10 reporting period.

27. Postage Stamp Pricing

Draft Finding 7.4 (p. 183) argues against widespread 'postage stamp pricing' where there can be efficiency savings.

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> *Charging the same price for water over large geographic areas irrespective of the different costs of servicing individual locations within those boundaries leads to inefficiencies and inequities. There is scope for efficiency gains in moving to more location-specific pricing, particularly where cost differences within 'postage stamp' areas (uniform pricing) are currently large and easy to quantify. In such cases, the benefits are more likely to outweigh the costs.*

This finding is relevant to Queensland where some areas have set prices according to sound financial principles, unhindered by restrictions of regulated pricing structures. There is a risk of cross-subsidising poor performers (rather than supporting remote and small communities) if postage stamp pricing were introduced.

28. Two Part Tariffs with Flexible Consumer Options

Draft recommendation 7.3:

> *More consumer choice in urban water tariff offerings should be available. This would:*
>
> - *allow consumers to express their preferences on security of supply and price stability*
> - *provide an opportunity for water utilities to manage demand better as water availability changes over time.*
>
> *Utilities would be required to provide default two-part tariffs with a single volumetric component*

would require service providers to adopt two part tariffs (a fixed component and a component based on volume consumed). The volume component would be based directly on volume used and not include an 'inclining block' structure where all water use within a defined range is charged at the same price.

In addition, it is recommended that flexibility be provided in how Tariffs are applied. This could mean for example that consumers could choose among a default tariff with a fixed price over a contracted period, a flexible tariff that would vary from year to year to reflect scarcity or a mixed tariff with fixed and flexible elements. It is likely that this structure would resonate with many users because of its similarity with fixed and variable rate home loans though as the Report states, water utilities might need to build experience in setting Tariffs to manage risk.

29. Queensland data on impact of tariff structures

It would appear that current tariff structures do not necessarily influence water use in all Queensland utilities. Figure 3 shows there is little relationship between

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average price and volume of water provided to residential premises despite the majority of utilities having tariffs with a volumetric component. There is also little evidence that smaller utilities, where the costs of service provision per capita might be expected to be greater, charge a premium for these services or that economies of scale in larger utilities allow for lower costs.

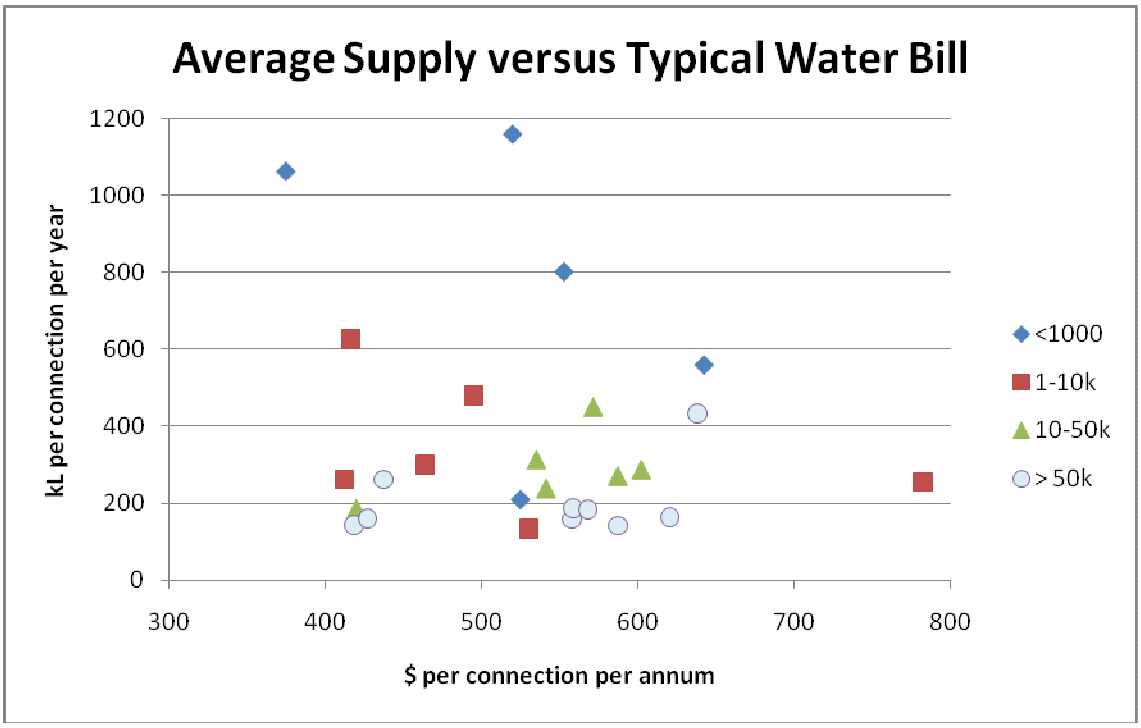

Figure 3.Average volume of water supplied to residences versus corresponding typical water bill for that supply grouped by utility size. Source: data submitted by service providers to the State-wide Water Information Management (SWIM) system for the 09/10 reporting period.

The lack of relationship is highlighted further in Figure 4, and may be due to insufficient data, price inelasticity, ineffectiveness of existing tariff structures or arbitrary pricing policies in some utilities. Regardless, it is likely that a review of pricing and tariff structures across Queensland utilities would be beneficial.

Figure 4 also indicates that there may not be a clear relationship between Tariff structure and water use. Some utilities argue that inclining block tariffs reduce water use, but it appears to be relatively consistent across larger utilities regardless of the tariff type adopted.

There is also clear evidence for high variability in both typical bills and average water use across smaller providers. There is insufficient data to determine whether this variability reflects climatic or other local conditions or cost of supply. It is also possible that price setting in some areas may be an artefact of historical pricing policy.

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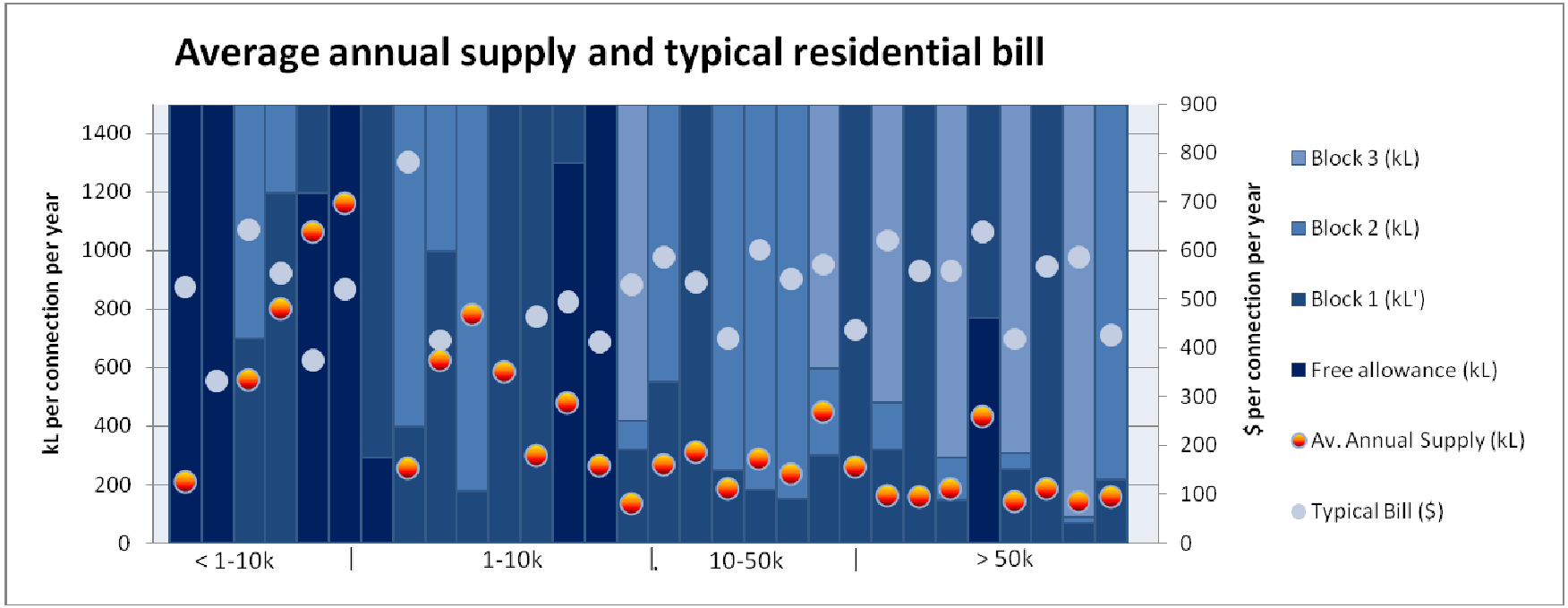
Figure 4.Average annual supply to residential premises and typical residential bill overlain on pricing structure. Source: data submitted by service providers to the State-wide Water Information Management (SWIM) system for the 09/10 reporting period.



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30. NWI Pricing Principles

The Report finds the NWI pricing principles to be unclear and request further information on what should be included in an improved set of principles. Draft Finding 7.5 is:

> *The National Water Initiative pricing principles are unclear and provide scope to implement pricing policies that are not necessarily in line with the principles of economically efficient pricing.*

When ***qldwater*** and LGAQ were consulted in setting the Principles, the process was rushed but as the principles were set at such a high level and were not immediately binding, both organisations endorsed the NWI Principles. Further consultation with adequate time frames would be necessary to further focus these principles.

Chapter 8 Non-price demand management

31. Costs and Imposition of Restrictions

qldwater agrees with Draft Finding 8.1 that:

> *Although apparently reasonably well accepted by the community, water restrictions generate costs for households, businesses and the community. They do so by denying consumers the opportunity to choose how to use water in the ways that are most valuable to them. The evidence suggests that the costs of restrictions are significant and can amount to several hundred million dollars per jurisdiction per year where they have been in place.*

Restrictions incur costs in some communities that do not appear to be warranted and which have not been justified on the basis on net benefit. Net benefits should include efficient use of water resources which in many Queensland towns must take into account the arid and unpredictable climatic conditions and the resultant increased need for water use to maintain quality of life. It is clear that the concept of 'efficient use' requires further definition in Queensland where water use varies markedly across the state (Figure 5). Based on the limited data available, this variation does not appear to be directly correlated with climatic conditions.

This may indicate that high water use is not always correlated with needs of the community and that efficiency measures (rather than water conservation) could be improved in some areas. In contrast in some areas water use is high for specific reasons (e.g. in Mt Isa where irrigation is encouraged to promote ground cover which reduces dust and the associated problem of poisoning (particularly of children) from the high surface lead concentrations).

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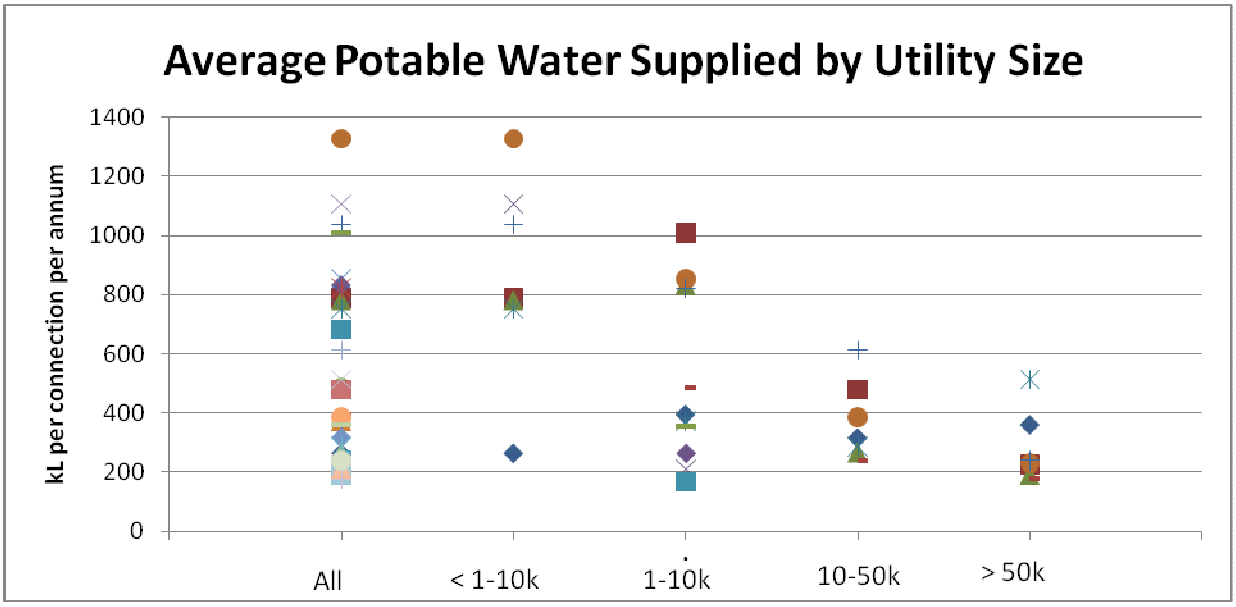

Figure 5.Average water use across a selection of Queensland utilities.

qldwater agrees with Draft Recommendation 8.1:

> *The use of water restrictions should be limited to times of emergency where a water shortage arises unexpectedly, or in regional urban areas where there are no viable new water sources available to augment supply and restrictions are needed to avoid running out of water. Consumers should instead be able to exercise choice in their water consumption behaviour through an efficient price mechanism.*

However, it is suggested that an agreed definition of 'running out of water' be determined as it is dependent on expected levels of service. In Queensland some local governments have been very efficient in managing their water use through conservation and efficiency measures selected to best fit their local circumstances. However, in some areas water conservation has not been applied soon enough, leading to community concerns over the security of water supplies. It should be noted that the size of the council managing the water business and the size of the community concerned may be a relevant factor, but it is clear that some small water utilities are extremely good at managing water security, while some larger communities have a poor record.

32. Support for the WELS Scheme

qldwater strongly endorses draft finding 8.2 (p. 209):

> *The WELS scheme has been successful at providing the public with an objective set of information with which to make informed decisions, and should continue.*

Stronger support and promotion of the WELS scheme would avoid some inefficiencies in information campaigns on water savings and efficient water use for the community. It is likely that greater ongoing benefit would have been achieved from investment in

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WELS rather than the heavy investment in water savings rebates over the past four years in Queensland.

This campaign would be strengthened by linking with energy efficiency. For example, the strong promotion of rainwater tanks in the past four years has often come at the expense of consideration of energy efficiency from the impact of water pumps. In some scenarios gravity-fed water tanks may be highly energy efficient, but in others the long-term costs and greenhouse impact will be high. Common water efficiency and energy efficiency ratings (or some combined rating) would provide a better signal to consumers about which options are most efficient for them in the long term.

33. Moving away from Government-mandated Water Efficiency and Conservation

Draft recommendation 8.2 (pp209-210):

> *Neither governments nor regulators should mandate water use efficiency and conservation activities, unless there is a market failure present and it is clearly established that the social benefits of intervention exceed the social costs.*
>
> *Government education and information campaigns should be refocused to provide more balanced information on the costs and benefits of water saving activities, as well as the relative merits of using prices, restrictions and water use efficiency and conservation measures to manage demand.*

is endorsed by ***qldwater*** with the caveat that market failures may be broader than those listed in the Draft report. Examples could include environmental benefits that are difficult to cost or trade. The Commission's view that environmental objectives are best pursued directly (see Chapter 3) ignores the fact that there are few levers that exist to help value environmental goods and services such as water and its flow. Those currently available through the water industry should not be abandoned hastily.

Another factor is that water use is subject to strong daily fluctuations that are not matched with equivalent price signals. This could change in the future with the installation of smart meters in some part of Queensland that could allow water tariffs to reflect daily demand cycles in a similar way to electricity.

Generally, refocussing information on broader efficiency measures taking into account relative costs and benefits is strongly supported. Such a campaign would need a degree of centralisation to save on communication costs and ensure efficiency of messages, but would also need to be flexible enough to take into account the diversity of situations, climatic conditions and community issues across a state such as Queensland.

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Chapter 9 Affordability and consumer protection

34. General consumer protection and rights to access water

Chapter 9 recommends solutions to the universal concerns of affordability and consumer protection and suggests that these issues should be addressed through centralised concessions. For example (p. 236):

> *Postage stamp pricing reform, as discussed in section 7.4, might lead to significant hardship in some country towns. The Commission is aware that the costs of supplying water and wastewater services vary considerably between country towns, in some extreme cases exceeding $30 per kL for water and $5000 per connection per year for wastewater services (ERA 2006). A transition to cost reflective prices in these circumstances would expose some communities to a significant burden.*
>
> *In these situations, the most efficient way of providing assistance would be to provide a lump sum payment to affected households, or for the service to be subsidised through a Community Service Obligation payment to water utilities. In order to maximise efficiency, whether subsidies are provided directly to households or to utilities, they should be independent of the actual level of consumption — the price of water should reflect the marginal cost of provision. In this way, it will not affect users incentives to conserve water. Addressing affordability issues in this way might not be feasible if high costs reflect high marginal, rather than high fixed costs*

These recommendations in general support the fifth Principle outlined by the Queensland Taskforce (see Appendix 1) that:

> **Principle 5: No community to be substantially disadvantaged (reasonable price for basic access).**

It is essential that any other institutional changes must be predicated on these community protection measures being implemented and proven. With this caveat, ***qldwater*** supports Draft Recommendation 9.1 (pp235-236):

> *COAG should commission a review of concessions on utility services across all levels of government. The review should assess:*
> - *the appropriateness of existing arrangements for providing concessions, including eligibility criteria*
> - *the merit of and scope for abolishing concessions and providing relevant assistance to all low income households via other elements of the tax and transfer payments system.*

and Draft Recommendation 9.2:

> *COAG should develop a set of best practice consumer protection principles for water utilities. These could be included in any new intergovernmental water agreement. At a minimum, the principles should include:*

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- *access to an independent dispute resolution process, preferably by a specialist utilities industry ombudsman*
- *the establishment of an industry code defining service standards and provisions to assist consumers facing hardship.*

35. Customer Service Standards in Queensland

Table 9.4 (p. 241) lists urban water consumer protection arrangements and does not reference specific arrangements for regional Queensland. Regional service providers are required under legislation to have published Customer Service Standards (CSS – seeWater Supply (Safety & Reliability) Act 2008 Chapter 2, Part 4, Division 5, s 115.). CSS apply to all urban WSPs (s 114) unless they have a service contract with all customers, or an exemption because they are small (s 146). Moreover, all service providers must be registered (s 20).

While the licensing and industry customer codes discussed in the text differ from these requirements for regional Queensland service providers, the table is misleading in suggesting that there are no consumer protection arrangements in place. Moreover, in many regional councils, the local government process itself provides a direct engagement process for consumers that may be more direct than an industry ombudsman (see also Comment 36 below).

Table 9.1 **Jurisdictional comparison of urban water consumer protection arrangements**

	Independent economic regulator	*Licensing of water utilities*	*Industry customer code*	*Independent dispute resolution*
NSW (metropolitan)	•	•		•
NSW (other)				•
Victoria (metropolitan)	•	•	•	•
Victoria (other)	•	•	•	•
Queensland (south-east)	•	•	•	•
Queensland (other)				•
Western Australia[a]	•	•		•
South Australia[a]				•
Tasmania	•	•	•	•
Northern Territory		•		•
ACT	•	•	•	•

[a]Western Australia and South Australia are currently reviewing their customer protection arrangements for water and wastewater services.

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36. Consumer Advocacy

Draft Recommendation 9.3 (p. 248) states:

> *COAG should progress implementation of measures to support consumer advocacy and research consistent with Recommendation 11.3 of the Commission's 2008 Review of Australia's Consumer Policy Framework.*

It should be recognised that consumer advocacy is undertaken in a widespread mechanisms through the provision of water services by Local Governments. The responsiveness of councils to the needs of their communities is often strong and capable of reflecting local and regional diversity. This recommendation would appear to be aimed at large urban or metro areas and would significantly change how consumers in regional Queensland express their preferences.

Chapter 10 – Framework for Reform

37. Need for context-sensitive change

Chapter 10 summarises the framework and need for reform. The ***qldwater*** position is that change is required in some aspects of the Queensland urban water industry, but wholesale reform is likely to ignore or remove benefits and efficiencies associated with the current industry structure. Consequently, ***qldwater*** strongly endorses the statement on pp 254-255, that:

> *The available literature on economies of scale and scope, and views expressed by many inquiry participants, suggest that significant efficiency gains could be achieved by increasing the effective size of small utilities, particularly in New South Wales and Queensland. Many of them, however, are operated by local governments and it is possible that in some cases their remaining functions would become less efficient if water were separated out into larger regional entities. The reform challenge, therefore, is to more fully exploit available economies of scale, while recognising possible impacts on the efficiency of local government and the benefits that local provision can have for consumers*

Chapter 11

Chapter 11 sets out a series of recommended institutional reforms that should be common to all jurisdictions. The Draft Report suggests that these reforms should be implemented regardless of specific jurisdictional reforms advocated in Chapters 12 (metro areas) and 13 (regional areas).

38. Charter for Water Utilities

qldwater endorses Draft Recommendation 11.1:

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Retail–distribution utilities should be assigned responsibility for meeting security of supply standards and procuring water supply and services.

and Draft Recommendation 11.2:

State and Territory Governments should draw up charters for urban water utilities incorporating best practice governance arrangements and governments' requirements for the performance of utilities.The charter would set out details about:

- *obligations to serve (security of supply and obligation to procure)*
- *transparent processes and procedures for choosing supply augmentations (public consultation, tenders for supply, public reporting of the decision, and monitoring by an independent body)*
- *principles for pricing and service offerings*
- *transparent processes and procedures for setting prices that involve public consultation, public reporting of decisions and periodic review by an independent body*
- *borrowing and dividend policies*
- *customer service standards/hardship policies*
- *risk allocation (between consumers, government shareholders and private suppliers)*
- *nature and funding of Community Service Obligations.*

There should be public consultation regarding the contents of the charter, and independent economic regulators in each jurisdiction would also be well placed to provide advice to the government. Independent economic regulators, or some other appropriate government agency in each jurisdiction, could oversee reporting against the charter.

Indeed these recommendations align well with Principle 10 expressed by the joint ***qldwater***/LAGQ taskforce (see appendix 1):

Principle 10: Creation of autonomously governed and managed sustainable water businesses to ensure among other things:

- Accountability;
- Management and technical capacity to appropriately respond to changing economic and technical regulatory frameworks (including reporting obligations);
- Capacity to provide for ongoing training, skills enhancement and development needs of staff; and
- Skills/experience based, independently appointed board/governance with minority representation by local councillors.

One important exception is the Taskforce's finding that Boards should include 'minority representation by local councillors' which may not be guaranteed under the recommendations of the Commission (see p. 268) and Recommendation 11.3 (see comment 39 below) which specifies independence of boards.

39. Governance Arrangements

Draft Recommendation 11.3 is that

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Governments should further improve governance arrangements for publicly owned urban water utilities. Areas for improvement include:

- *governments setting overall water security and reliability objectives, and requirements for wastewater, stormwater and flood mitigation*
- *further separation between Ministerial and board governance*
- *greater definition and alignment of objectives and assignment to appropriate agencies*
- *implementing procedures to ensure independence of boards*
- *regular reviews of Community Service Obligation payments*
- *regular reviews of board performance*
- *greater flexibility regarding dividend payments to ensure they are consistent with investment intentions. Initial recommendations on payments should be made by boards.*

qldwater supports this recommendation in line with the Principles outlined by the Queensland Taskforce (Appendix 1) with two important exceptions. These are (1) that, dividends should be returned directly to communities of local governments that own the water utilities and (2) that board membership should include minority local government representation (see also comment 38).

40. Rejecting Economic Regulation?

qldwater agrees that (p. 273):

> *Independent economic regulation of urban water utilities has been seen as important in the absence of competitive markets because the alternative has traditionally been high levels of political interference in pricing. This has meant prices have often been set at levels well below cost recovery levels, possibly leading to inefficiently high water consumption and probably resulting in underinvestment and deferred maintenance.*

but questions the conclusion (p. 275) that "governance arrangements are likely to be more effective than regulation in dealing with underrecovery". This conclusion relies on widespread adoption and implementation of the recommendations of the report. If implementation is instead patchy over space and time then the recurrent issues of inappropriate price setting will remain in the industry (see also Comment 1). Independent price regulation could remove this problem with more certainty and rapidity.

Draft Recommendation 11.4 :

> *State and Territory Governments should move away from regulatory price setting to a price monitoring regime (where some form of prices oversight is considered necessary). Within five years of moving to a price monitoring regime, all State and Territory Governments should initiate independent reviews (not by regulatory agencies) to determine:*
>
> - *whether water utilities are abusing their market power and, if they are, what action should be taken to deal with this*
> - *whether ongoing price monitoring would likely produce net benefits to the community and, therefore, whether it would still be required. If such benefits*

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cannot be demonstrated, all price regulation should be abolished and replaced by a self-reporting regime to be overseen by an appropriate government agency in the relevant jurisdiction.

Rather than proceeding to implement a price setting regime, Queensland should continue with its interim price monitoring arrangements until it undertakes a review of whether price regulation produces net benefits to the community.

The National Water Initiative pricing principles should be amended to remove any reference to independent regulatory price setting, except where it can be demonstrated that a more light handed approach as described above would be unlikely to prevent an abuse of market power.

is endorsed by ***qldwater*** only on the grounds that other Recommendations are adopted and uniformly implemented such that appropriate governance arrangements for water are in effect first (and with the caveats expressed at comments 38 and 39).

41. Consumer involvement in setting water industry directions

The Draft Report argues that consumer involvement in decision making is often limited and "in the absence of such information, decision makers have to simply 'make up' consumer preferences as they have no other source of information" (p. 281). ***qldwater*** accepts that consumer engagement can always be improved, but argues that the local government model in Queensland is very responsive to consumers (see also comment 36).

Local Governments closely monitor consumer preferences and do so at a local scale. Indeed, one of the common arguments against horizontal aggregation is the loss of this local focus (see below at point 56). Despite the limitations of this model it is highly questionable whether a new consumer representative group would provide a better model for expressing consumer preferences. Consequently, ***qldwater*** does not support Draft Recommendation 11.4:

In urban water, there is no competitive market-based mechanism to reveal the preferences of individual consumers regarding potential service offerings, such as the willingness of individual consumers to pay for different levels of reliability and security of supply. One possible way to facilitate the revelation of such consumer preferences is through the use of representative consumer groups.

42. Third Party Access

qldwater makes no comment on Draft Recommendation 11.5:

The Australian Government should proceed with the scheduled independent review of the National Access Regime. This review should commence no later than 31 December 2012. The terms of reference should include an examination of all state-based access regimes, including those for the urban water sector.

but requests that the Queensland urban industry be consulted meaningfully in the review should it proceed.

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43. Governance arrangements for regulators

Draft Recommendation 11.6:

> *Environmental and health regulators should be more transparent and accountable in their decision making. Except in matters where urgent public or environmental safety issues are involved regulators should also publish draft decisions and seek public comment on these. They should publish the reasons for their decisions in a similar manner to economic regulators and governments should consider the development of appropriate decision review mechanisms.*

refers only to environmental and health regulators, but in Queensland, the Office of the Water Supply Regulator has a major impact on the urban water and sewerage industry. The recommendation is supported by ***qldwater*** if it is expanded to encompass this area of water industry regulation which is also in need of reform.

44. Water trading

qldwater makes no comment on Draft Recommendation 11.7:

> *All remaining impediments to rural–urban trade, particularly volumetric restrictions and excessive termination fees, should be removed as soon as possible.*

or Draft Recommendation 11. 8:

> *Any bans (legislated or otherwise) preventing trade between regional water utilities should be independently reviewed and, if it cannot be shown the bans provide net public benefits, they should be removed.*

Chapter 12

45. Additional bulk water suppliers in large metro markets.

'Option 2' (Section 12.2, p. 327) proposed in the Draft Report calls for greater competition in the bulk water supply segment of the water cycle in large metro areas: "Importantly, this option encourages private bulk water service providers to enter the market for service provision" (p. 332). It is not clear from the limited examples provided that this option is viable. General comments from the Queensland industry have been that because of the initial setup risks, pumping costs and ongoing uncertainty of supply and demand, that real competition among bulk water entities is unlikely.

Some of the evidence provided in the Draft Report for benefits for horizontal disaggregation of bulk water functionsis unconvincing. For example, the description of the Queensland Water Commission's determination "that there was benefit in having multiple entities rather than a single bulk water provider (it was ultimately determined that two bulk water supply businesses be established in south-east Queensland —

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WaterSecure and SEQWater" (p. 339) was reversed within two years of establishment. This is actually noted on the following page (p. 340) of the Draft Report which notes "in late 2010 the Queensland Government determined that it would be cost effective to reintegrate the two bulk water supply businesses"and that "that the merger would give rise to cost savings in the range of $18 million per year".

It is also difficult to link the "VCEC's decision to retain the separation of the retail-distribution function in metropolitan Melbourne, despite the cost savings on offer [from their amalgamation]" (p. 339) to the horizontal separation of bulk water entities in general.

Overall, the case for horizontal separation of bulk water in large metro areas is confusing in the Draft Report and not well supported. More viable examples or analysis need to be provided to support this element of option 2 which currently detracts from the arguments for vertical separation of bulk and retail water functions.

46. Option 3 Wastewater treatment separation

Separation of sewage treatment is not opposed so long as it is undertaken after a rigorous cost benefit analysis. Two important costs are not mentioned in the Draft Report. First is the impact of third party 'sewer mining' on the flows and the treatment processes at sewage treatment plants. This impact is an additional cost that needs to be borne by the current owner of the sewage collection and treatment systems.

Second, given the potential for commercial failure in a competitive market, there are risks and costs to local or state governments to resuming control of failing enterprises and re-integrating treatment into base flows and loads of a sewerage system. This cost should be recognised and accounted for in any analysis.

47. Horizontal separation of retail-distribution

Option four has been an issue of intense debate in Queensland, particularly in the south east corner and it would be beneficial to see some analysis of size thresholds at which economies are realised and diseconomies avoided. Previous decisions on the scope of horizontal aggregation appear to be primarily politically motivated and objective criteria are difficult to source.

Chapter 13: Reform in Regional Areas

48. Distance between regional schemes in Queensland

On p. 373 in referring to the difficulty of achieving economies of scale through aggregating regional communities it is noted that "regional water utilities generally have limited options for diversification due to their location — for example,

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w: www.qldwater.com.au e: enquiry@qldwater.com.au

establishing physical linkages between water supply systems may not be feasible or cost-effective". It should be noted that there are few townships in regional Queensland that can be effectively connected due to the large separation (and often small size) of the schemes.

This issue needs to be recognised more strongly in the report, given that many economies of scale arise through connected networks and that the report recognises that distance between networks e.g. p. 319:

> *it would be inappropriate to expect the same scale impacts in a water system where new customers are connected to a separate network (especially if the new network is located at a considerable distance from the existing network).*

49. Variable sustainability among Queensland providers and capacity for change in very small providers.

The Inquiry found that "in many areas — regional water utilities are financially sound, compliant with regulatory and legislative requirements and responsive to changing demand and supply conditions, and that services are provided to customers in an efficient and effective manner" (p. 375). This is certainly true of parts of regional Queensland where there are examples of best practice or beyond among local government utilities. The recognition of high-performers is essential and is reflected in the recommendations in the Draft Report which favour a case-by-case cost benefit analysis of reform in regional Queensland.

This is particularly important for very small or very remote communities where water services may be unsustainable solely because of size and location of a community. This is repeatedly acknowledged in the Draft Report e.g. p. 376:

> *"It is important to recognise that the capacity of reform (of all kinds) to remove or even reduce some of the challenges facing regional water utilities is limited. Indeed, some small, remote regional water businesses face extremely challenging circumstances that are beyond the control of the utility, and are unlikely to change irrespective of the reforms adopted."*

These statements highlight importance of recommending change that is 'fit-for-purpose'. The variability in Queensland service providers is highlighted in data on Economic Real Rate of Return for a number of councils that have provided data via the State-wide Water Information Management (SWIM) system. Table lists the median and range of values for Queensland utilities in the format reported in the Draft Report. The Queensland data are more recent but use the same metric as the National Performance Report that is reported in Table 2.15 of the Draft Report.

Table 1. Economic Real Rate of return (median and range) reported in the PC Inquiry draft report versus recent Queensland data.

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Number of connected properties	Economic Real Rate of Return (%)		Number of Qld utilities in each category
	2008/2009 National Utilities[1] median (range)	2009/10 Qld Utilities[2] median (range)	
> 100,000	2.4 (1.2 - 9.9)	7.8 (3.2 – 10.3)	3
50 - 100,000	0.9 (-1.0 – 6.8)	3.5 (0.1 – 11.1)	4
20 – 50,000	0.85 (-2.3 – 5.7)	4.0 (-3.09 – 4.2)	3
10 – 20,000	0.9 (-2.3 – 5.9)	2.6 (1.7 – 3.6)	2
< 10,000	no data	0.1 (-3.4 – 3.9)	9

1. PC Inquiry Draft report (Table 2.15)
2. SWIM data reported to ***qldwater***.

It is clear that there is a broad range in the financial returns across Queensland service providers. However, many (though not all) small councils struggle to provide significant returns from their water business. This is due to a range of issues including size and remoteness that cannot be remedied through structural reform. It could be the case as is suggested in the report that "in extreme circumstances, assistance from government may be required to ensure compliance with mandatory standards" (p. 383).

50. Potential benefits from horizontal aggregation of activities

It is suggested that through horizontal aggregation. "operating costs might reduce if neighbouring water businesses are able to share resources (such as skilled labour, corporate services or administrative functions) to exploit economies of scale efficiencies, all else equal. Alternatively, aggregated utilities might be better placed to access debt capital relative to stand alone entities." ***qldwater*** strongly supports this statement.

Queensland water service providers have for a long time undertaken cooperative projects and shared resources both formally and informally. The Water Directorate itself was started by the industry and is funded by the industry for this purpose and has for some years been building joint capacity through collaborative approaches in the areas of skills, and technical and managerial services. This work has been undertaken in partnership with LGAQ whose programs, *inter alia*, increase efficiency amongst local governments in administrative and corporate services.

Specifically, over the past year, a joint Memorandum of Understanding among ***qldwater***, LGAQ and the Department of Environment and Resource Management has seen the roll out of a number of projects to increase capacity and collaboration across the industry. It is difficult but essential that the benefits arising from existing collaborative arrangements along with the economies of scope resulting from shared resources within local governments (see e.g. p. 405 of the Draft Report) be examined in any cost benefit analysis of further horizontal aggregation.

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w: www.qldwater.com.au e: enquiry@qldwater.com.au

51. Skills shortages

The issues relating to the current and increasing skills shortage issues are well summarised for Queensland. This is seen as one of the key priorities for the state and this recognition is reflected in the Skills Formation Strategy hosted by ***qldwater*** with a steering committee consisting of senior managers and leaders from SEQ and regional Queensland representing all State and local government urban service providers. This Industry Leaders Group has strong links with the national skills programs and has representatives on the Water Industry Skills Taskforce (and its subsidiary Water Industry Skills Advisory Group), and the Water Industry Advisory Committee for the Industry Skills Council responsible for water (namely Government Skills Australia).

In the past three years, joint projects administered by ***qldwater*** to improve skilling across the urban industry have amounted to an investment of nearly $1 million and have influenced the entire industry. In addition through negotiation between the industry and the Queensland Department of Education and Training over $1 million in additional training places have been provided to the industry. The national programs listed in the Draft Report are essential but are generally fairly recent and have not yet seen significant investment in improving skills development for the urban water industry in Queensland.

The skills crisis for the water industry will not be solved simply through institutional restructure although there could be some benefits through regional collaboration. Regardless, it is agreed that "shortages at the operational level will not necessarily be solved via amalgamation" (p. 397).

52. Compliance with public health standards

Compliance with public health standards and uptake of the Australian Drinking Water Guidelines (ADWG) is patchy across Queensland. As indicated in the draft report, small and remote councils in particular can have difficulty in demonstrating compliance. The barriers to achieving full compliance are numerous but notably, do not include diligence or focus on public safety by water industry workers themselves. Often issues are unexpected.

For example, many small and remote councils in Queensland have difficulty in transporting water samples for the measurement of pathogenic bacteria to appropriate laboratories within the requisite time for such tests. Even when this is possible, the results of such tests can be returned too late to appropriately influence ongoing management actions. In response, ***qldwater*** and LGAQ have been promoting the use of instantaneous testing kits with appropriate quality assurance through regular lab validation. This model has been supported by the Department of Environment and Resource Management (DERM) and Queensland Department of Health.

DERM are currently rolling out Drinking Water Quality Management Plans (DWQMPs) for all potable water service providers and are collaborating strongly with

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qldwater and LGAQ in this process. In fact the development of DWQMPs, which will essentially bring all service providers in line with the ADWG has been one of the most collaborative and fit-for-purpose programs implemented by the regulator in some time. Regardless, it is likely that some small providers will struggle to achieve compliance with the full guidelines (i.e. beyond *E. coli* compliance). It is not clear that aggregation will overcome such problems as is suggested on page 390:

> *aggregation is expected to provide utilities with greater financial capacity to undertake efficient investment, and better access to skilled staff, which in turn should improve utility performance against these standards*

Indeed, as is stated on p. 391:

> *Regional water utilities face a range of complex economic, demographic and geographic challenges, and there is no 'one size fits all' solution to addressing these issues. In certain cases there may be no solution, as some of these issues reflect the reality of water supply and wastewater service provision in regional areas, and will not be removed or even alleviated via reform.*

53. Regulatory and administrative burden

Issues of regulatory and administrative burden listed on pp 390-391 are certainly true for Queensland. A large raft of legislative requirements introduced over the past five years appear to have been created without any meaningful regulatory impact analysis or consultation with the industry resulting in expensive and time consuming requirements that are beyond the ability of some service providers to incorporate in the required timeframes.

The industry, ***qldwater*** and LGAQ have sought a more inclusive and cooperative model to jointly address key regulatory issues facing the industry. This cooperation has improved immensely over the past year with the creation of a joint MoA among ***qldwater***, LGAQ and DERM. It is essential that future change (including that potentially arising from the PC Inquiry) be undertaken in a collaborative manner that fully involves the industry rather than reverting to tokenistic communication.

54. Economies of scale efficiencies from horizontal aggregation in Queensland

Potential economies are discussed on p. 394 with the suggestions that "an aggregated business may be able to service all customers using one wastewater treatment plant in place of multiple plants, or deal with all customer complaints via a single complaints department. An aggregated utility may also realise economies of scale in procurement, administration and training". The benefits of sharing administrative structure such as complaints departments would need to be assessed against the current economies of scale achieved through sharing such functions across a local government business.

Queensland Water Directorate ***(qldwater)***, Level 1, 25 Evelyn Street, Newstead Qld 4006. p: 07 3252 4701
w: www.qldwater.com.au e: enquiry@qldwater.com.au

Many of these potential benefits are real and are being increasingly explored by through regional collaboration among Queensland utilities. To avoid confusion it should be stated that in Queensland the practicality of sharing treatment plants is low. In Queensland, unlike in Tasmania (and perhaps parts of Victoria), separation of water schemes is often one of distance rather than mere "lines on a map" (p. 395). The geographical scale covered by horizontal aggregation in Queensland may not negate but will certainly mitigate potential benefits. This issue is specifically recognised in the Draft Report on p. 397 where it is stated that "the magnitude of scale benefits (if any) from horizontal aggregation must be assessed on a case-by-case basis, with due regard to the specific circumstances of the region".

The suggestion that "the aggregated utility is also expected to take a more region-wide approach to water system planning relative to the predecessor local council utilities" (p. 400) is unlikely to provide a significant benefit in Queensland where regional water resource planning is currently undertaken by the State in consultation with local governments and other stakeholders.

55. Yardstick competition

Queensland has been criticised for a lack of public benchmarking. This issue is being remedied through the State-wide Water Information Management (SWIM) system which has been collecting data from an increasing number of service providers over the past three years. Over 80% of non-indigenous councils now report through the SWIM system which uses NPR indicators and definitions among a group of over 200 indicators. Not all indicators are currently submitted by all councils but this voluntary reporting has increased significantly since the first year of reporting. This year will see the first voluntary public report of benchmarking information by a self-nominated group of councils. For the past three years, councils have been able to benchmark their performance anonymously against medians of other councils of similar size, similar climatic region or similar soil size.

In the absence of current public benchmarking it is difficult to speculate on the extent to which yardstick competition takes place among councils at present and whether this would increase following horizontal aggregation.

56. Real and perceived concerns and costs for aggregation

Some of the key concerns of Queensland service providers are recognised in the Draft Report as potential costs of horizontal aggregation of councils. These include:

- "impacts it might have on the financial sustainability of councils and on local and regional economies and employment", (p. 403)
- "more costly and difficult [attraction of] skilled staff to local government councils once responsibility for water is transferred", (p. 406)

Queensland Water Directorate ***(qldwater)***, Level 1, 25 Evelyn Street, Newstead Qld 4006. p: 07 3252 4701
w: www.qldwater.com.au e: enquiry@qldwater.com.au

- "loss of jobs in areas as new utilities seek to exploit the benefits of greater scale", (p. 407)
- "fear that aggregated regional utilities will be less focussed on – and accommodating of – the particular circumstances of individual communities leading to the deterioration of service quality", (p. 407).

In recognising these potential costs the Draft Report concludes that precise benefits and costs need to be assessed on a case-by-case basis"

> *there may be merit in corporatising the stand alone utility, or conversely, adopting a more informal approach to resource sharing, such as a regional alliance .Alternatively, the best solution may be to retain the current local council water utility model, pending implementation of the various reforms set out in chapter 11 [of the Draft Report]. In extreme cases, direct funding from relevant State and Territory Governments may be necessary to ensure adequate provision of services, especially in relation to drinking water quality.*

One common concern of service providers, and potential cost of aggregation, is the consideration of unequal cross subsidisation between aggregated councils. While the Draft Report focuses on the potential benefits and savings that can be achieved through scale, there is also a perception that aggregation merely distributes funds from larger or better performing utilities (communities) to cross subsidise smaller/less financially viable towns. High performing Queensland service providers have expressed a concern that this amounts to a penalty for 'doing the right thing' and receive pressure from their communities to focus rate income 'on their own back yard' rather than diluting it across distant 'satellite' communities.

This perception has been heightened by regular informal suggestion by the State government that larger utilities should be assisting nearby communities that have lesser capacity. In reality, this already occurs to a large extent and is often seen as a defining feature of the resilient and supportive nature of the Queensland urban water industry. The disconnect lies in the equal pressure for utilities to be performing in a more transparent economically efficient manner which reduces the likelihood of purely altruistic sharing of resources (as has been the case in the SEQ institutional changes).

To the extent that cross-subsidisation is likely following horizontal aggregation, it represents an inefficiency. Communities with higher capacity may end up supporting those with a lesser capacity in an unequal fashion placing a greater burden on some regions than others. In jurisdictions such as WA and SA where a single state-wide entity manages the water business it is understood that large metro areas cross-subsidise small regional communities. This is not possible in Queensland because of the erratic but entirely independent restructure and 'corporatisation' of the metro area in SEQ.

Caution should also be promoted by the local government amalgamation process that occurred in Queensland in 2008. The Draft Report notes that "Queensland has also made significant progress toward utility consolidation in recent years (as part of a

Queensland Water Directorate ***(qldwater)***, Level 1, 25 Evelyn Street, Newstead Qld 4006. p: 07 3252 4701
w: www.qldwater.com.au e: enquiry@qldwater.com.au

broader local government reform program), particularly in south east Queensland". it should be noted that even during this wholesale amalgamation process many of the small population but large area councils in western Queensland were not combined due to reasons of practicality. Moreover, the restructures in Queensland have been costly and politically complicated and have not yet settled to a stable state.

57. Potential models

The potential models considered for regional Queensland and NSW are:

- regional water corporation, (p. 411)
- county council, (p. 413)
- regional alliance model, (p. 415) which is either binding or voluntary (p. 416).

The county council model is unknown in Queensland but there are four local government-owned corporations/ statutory authorities (namely Wide Bay Water, and the three distributor-retailers in SEQ), and a number of voluntary regional water alliances (e.g. the Cairns, Townsville Mackay alliance and the RAPAD group of councils).

While the Draft Report considers the costs and benefits of which of the models it does not specify a specific model for any particular region preferring as case-by-case analysis as per Draft Recommendations 13.1:

> *There is a strong case for undertaking aggregation of small water and wastewater utilities in regional areas of New South Wales and Queensland. The precise approach — including identification of affected councils and the preferred grouping of councils — should be assessed and determined by relevant State Governments, in consultation with Local Governments and affected communities.*
>
> *This process should consider the relative merits of alternative organisational structures, including:*
> - *county council*
> - *regional water corporation*
> - *regional alliance (or regional organisation of councils).*

and 13.2:

> *The New South Wales Government should provide a formal response to the recommendations of the Armstrong and Gellatly inquiry as a matter or priority.*
>
> *The Queensland Government should commence a similar process, in consultation with Local Governments and communities, to consider the costs and benefits of different structural reform options for the urban water sector in regional Queensland (outside of south-east Queensland).*

However, the Draft Report is clear that "on balance, the Commission considers that establishing a voluntary regional alliance will deliver more modest benefits relative to

Queensland Water Directorate ***(qldwater)***, Level 1, 25 Evelyn Street, Newstead Qld 4006. p: 07 3252 4701
w: www.qldwater.com.au e: enquiry@qldwater.com.au

utility aggregation and corporatisation, all else equal" (p. 419). Similarly, with respect to county councils: "despite the merits of both approaches, the Commission considers that where aggregation of regional water utilities is determined to be efficient, a corporation structure is preferable to the county council model" (p. 414).

qldwater endorses Draft Recommendations 13.1 and 13.2 only if the process is undertaken with the requisite cost-benefit analysis in partnership with local communities as represented through local government councils, and subject to government funding (see point 44). In addition the Queensland Taskforce (see Appendix 1) specifically stipulated local government ownership of water entities under any new model (**Principle 9**: Local Government to retain ownership).

58. Government Funding For Specific Circumstances

The Draft Report sets out specific cases where government funding is required to support the regional water industry (p. 421). These are:

- uneconomic regional utilities, (p. 421)
- short-term capital works assistance, (p. 423)
- financial incentives for reform to encourage external benefits, and
- financial assistance/compensation for reform.

These findings lead to Draft Recommendation 13.3:

> *Jurisdictions should identify those regional utilities that are unable to provide safe and secure water and wastewater services for economic reasons. In doing so, the relative merits of alternative supply options (including moving to a system of self-supply) should be considered.*
>
> *State and Territory Governments should subsidise the provision of water supply and wastewater services in regional areas where it is uneconomic for the utility to provide these services safely and efficiently. This funding should be granted via an explicit Community Service Obligation, and subject to periodic review.*
>
> *The case for providing subsidy funding for capital works, financial incentives for reform and assistance for affected local councils should be determined by State and Territory Governments.*

It is worth noting that some local government alliances that have formed voluntarily in Queensland have been motivated by medium and long term savings through economies of scope and scale but have required initial funding to overcome immediate transaction costs. ***qldwater*** and LGAQ are jointly seeking to create further opportunities for alliances by assisting with bridging this initial barrier to collaboration.

Queensland Water Directorate ***(qldwater)***, Level 1, 25 Evelyn Street, Newstead Qld 4006. p: 07 3252 4701
w: www.qldwater.com.au e: enquiry@qldwater.com.au

59. Specific Needs of Aboriginal Communities

Specific challenges faced by indigenous communities are considered (p. 424) and it is concluded that "It is essential that water supply and wastewater outcomes in Indigenous communities are assessed on the same metrics that are used for non-Indigenous communities (and likewise, that public reporting on water and wastewater outcomes is consistent across both groups)." The corresponding Draft Recommendation 13.4 is that:

> *State and Territory Governments should undertake regular, public reviews of water and wastewater outcomes in Indigenous communities. Water and wastewater services should be assessed against the same metrics that are used to measure service quality in non-Indigenous communities.*

qldwater agrees in principle with this recommendation but in practice equity cannot be achieved because of perverse incentives and intrinsic differences existing in some indigenous communities.

One example is that the existing financial framework for ***qldwater's*** aboriginal council members. While the two Torres Strait Island councils often perform well compared with other similar councils, aboriginal councils face a range of additional difficulties. In particular, the funding structure for the councils (which have no water rates) is such that bulk funding is provided to the council on a regular basis with no hypothecation of funds to water and sewerage services.

As well as this disconnect in funding there are clearly no price signals for water and this is compounded in some communities by cultural perceptions of water as a free resource. In addition, many aboriginal communities have problems of attraction and retention of staff that are additional to other small and remote communities. These factors combine to mean that these communities often have difficulty in prioritising and maintaining infrastructure in a way that differs from many other small and remote towns.

Assessing Queensland's aboriginal communities alongside other remote regional communities is highly desirable, but will not immediately remedy the specific problems associated with water services in these communities. This recommendation also ignores all previous discussion on the costs and inefficiencies of maintaining small communities in contrast to horizontal aggregation. All of the pressures listed in the draft report for small communities are common to the majority of aboriginal communities.

60. Compliance with the Australian Drinking Water Guidelines

Draft Recommendation 13.5 is strongly endorsed by ***qldwater***(p. 427):

> *Compliance with the health critical elements of the Australian Drinking Water Guidelines should be mandatory, and implemented via legislation.*
>
> *Utility performance against all elements of the Australian Drinking Water Guidelines should be publicly reviewed and reported on annually by State and Territory Governments. Sanctions should apply if water utilities do not comply with the*

Queensland Water Directorate ***(qldwater)***, Level 1, 25 Evelyn Street, Newstead Qld 4006. p: 07 3252 4701
w: www.qldwater.com.au e: enquiry@qldwater.com.au

mandatory elements of the guidelines, and directors or other accountable persons such as councillors should be personally liable for the risks associated with non compliance.

Utilities that do not comply with the non-health critical elements of the guidelines must develop and implement a risk management plan (approved by the relevant health department) that will move the utility toward full compliance with all elements of the guidelines.

61. Disaggregation of jurisdiction-wide public water corporations

qldwater has not comment on Draft Recommendation 13.6 but acknowledges the Commission's holistic analysis compared with other national reviews that seem to automatically assume that jurisdiction-wide water entities are viable options.

Draft Recommendation 13,6 states (p. 429):

The Governments of Western Australia, South Australia and the Northern Territory should consider the costs and benefits of replacing the single, jurisdiction-wide public corporation model with a regional water corporation approach (horizontal disaggregation).

In undertaking this analysis, relevant State and Territory Governments should consider factors other than scale, including opportunities for yardstick competition, the proximity of utilities to the customers they serve, opportunities for more location-specific pricing arrangements and the effectiveness of water resource management and water system planning.

Chapter 14 – Implementing reform and monitoring progress.

62. Implementation of Universally Applicable Reforms

qldwater supports the Draft Recommendation 14 .1 (p. 434):

Governments should implement the universally applicable reforms to policy, governance and institutions identified by the Commission. These should be the highest priority for reform of the urban water sector as they present the greatest scope for efficiency gains, and are an essential precursor to pursuing structural reform. These universally applicable reforms centre on:

- *setting an overarching objective for government policy in the sector for the provision of water, wastewater and stormwater services in an economically efficient manner to maximise the net benefits to the community*
- *developing appropriate policies and principles that align with this objective*
- *putting in place best practice institutional, regulatory and governance arrangements.*

Queensland Water Directorate ***(qldwater)***, Level 1, 25 Evelyn Street, Newstead Qld 4006. p: 07 3252 4701
w: www.qldwater.com.au e: enquiry@qldwater.com.au

with the qualifications listed above. In effect this amounts to implementing the reforms recommended in Chapter 11 of the Draft Report while leaving the specific recommendations for large metro areas (Chapter 12) and for regional Queensland (Chapter 13) to be implemented at the discretion of each jurisdiction.

63. Immediate State and Local Government Action

qldwater agrees with Draft Recommendation 14.2 (p. 440):

> *Agreement across all jurisdictions is not necessary for the State and Territory Governments to pursue the recommendations made by the Commission as most relate to implementation of best practice. The State and Territory Governments should immediately commence enacting reforms unilaterally.*

but notes that this must be sensitive to regional needs and be undertaken with appropriate consultation. The process of sudden reform with limited consultation of local government and the water sector in Queensland over the past five years has left a legacy of distrust and ill-will among all stakeholders. Sustainable change that meets the needs of regional communities can be achieved only through collaborative approaches.

This is particularly important in regional areas where "governments have often failed to deal with the social dislocation that can occur with economic reform" (p. 441). ***qldwater*** strongly endorses the statement that "the Commission considers that it is important to recognise up front any adjustment or distributional consequences of reform, and to agree up front about the general principles that should apply to the provision of any transitional assistance that might be provided to those affected" (p. 441).

64. Monitoring and Review.

The final two draft recommendations are supported by ***qldwater*** namely Draft Recommendation 14.2 (p. 443):

> *Progress against COAG agreed water reforms should be subject to monitoring. The National Water Commission would be the most logical body to undertake such monitoring.*

and Draft Recommendation 14.4 (p. 444):

> *An independent public review of the reform package should take place after five years.*

Queensland Water Directorate ***(qldwater)***, Level 1, 25 Evelyn Street, Newstead Qld 4006. p: 07 3252 4701
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Appendix 1 – Queensland Taskforce Principles to Guide Reform of the Queensland Water Industry

LGAQ and ***qldwater*** believe these principles can provide guidance to all levels of Government in determining objectives for the urban water sector. These principles were derived by an industry taskforce, ratified by the LGAQ executive and presented to the State Government. They were also provided in the original LGAQ and ***qldwater*** submission to the Inquiry.

1. Efficient and effective service delivery and resource use.
2. Equitable and transparent water sharing across and between regions.
3. Needs of individual communities to remain a vital driver of management, policy andplanning.
4. Management of water businesses needs to deliver returns that allow for appropriate assetrenewal with a dividend on assets returned tothe community through Local Government (with no cross-subsidisation of other council services).
5. No community to be substantially disadvantaged (reasonable price for basic access).
6. Water planning framework to be consistent across the state.
7. Water planning and management needs to be directly linked with statutory and land useplanning activities of Local Government.
8. Long-term sustainable asset management (taking into account, for example, WaterSensitive Urban Design, System Supply Losses,Integrated Water Cycle Management and maximising the benefits of vertical integration).
9. Local Government to retain ownership.
10. Creation of autonomously governed and managed sustainable water businesses toensure among other things:
    - Accountability;
    - Management and technical capacity to appropriately respond to changing economicand technical regulatory frameworks (includingreporting obligations);
    - Capacity to provide for ongoing training, skills enhancement and development needs of staff; and
    - Skills/experience based, independently appointed board/governance with minority representation by local councillors.

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