Submission to the Productivity Commission's Public Inquiry into Australia's Urban Water Sector

Addendum
Council of Mayors (SEQ)
June 2011

Council of Mayors
South East Queensland

About the Council of Mayors (SEQ) Pty Ltd

The Council of Mayors (SEQ) was established in September 2005 as an independent political advocacy organisation to represent the interests of one of Australia's fastest growing region – South East Queensland (SEQ). It proactively seeks cooperation of Federal and State Governments to ensure the long-term sustainability and liveability of SEQ communities.

The Council of Mayors (SEQ) represents a region that is home to more than three million people (1 in 7 Australians) and generates one quarter of Australia's population growth and one fifth of the nation's economic growth. Five out of the six largest councils in Australia are from SEQ, which is no longer just a series of disparate geographic areas but a region that, in practical terms, now functions as a single metropolitan area.

EXECUTIVE SUMMARY

The Council of Mayors (SEQ) welcomes the opportunity to provide additional comment for the Productivity Commission's public inquiry into Australia's Urban Water Sector. This acts as an addendum to the Council of Mayors (SEQ) January 2011 submission.

In 2007, South East Queensland earned the distinction of becoming one of the first major metropolitan regions in the world to almost run out of water. With $7 billion of borrowed State funds later, we have now earned the reputation as having some of the most expensive white elephants in water infrastructure in Australia, with a $2.5 billion recycling system the Government had pledged not to turn on until dams are below 40 per cent, a $1.2 billion desalination plant that won't be turned on until dams are below 60 per cent, and a pipeline to a dam the State never built - but spent $265m in non-recoverable costs in not doing it.

South East Queensland has the most cumbersome water entities reform structure in the world, where vertically integrated council owned water businesses have been replaced by a structure where water passes through five different vertically separated structures from the dams to taps. Worse still, South East Queensland has the fastest growing State bulk water price in Australia, which has doubled since these 'reforms' started in 2008 - and will double again by 2018.

And now, Queensland is responsible for the most flagrant breach of National Competition Policy COAG Agreement by a State Government in Australia with the State imposing a cap on council-owned water utilities without any consideration of the impact that might have on their financial position. This is despite SEQ being the fastest growing metropolitan region in Australia, facing a changing climate that has reduced the yields expected from our key water catchments by around 40 per cent.

Water supply in SEQ is unusual in that retail-distribution functions are owned by 10 SEQ councils, while bulk water is owned (since 2008) by the State Government. The assets owned by councils have been valued at around $11 billion, placing our three water businesses among the largest GOCs in the country.

Councils are very proud of the performance of their water businesses. According to the National Water Commission (NWC), for example, Brisbane Water, owned by Australia's largest local authority, in its last year of operation (2009-10) delivered the second cheapest water (second only to Melbourne) of any mainland capital city. This was despite it facing the highest operational cost - driven by significant (and increasing) increases in the State Government Bulk Water Charge. Brisbane Water did this by delivering a NPAT ratio of just 12 per cent, well below the 21 per cent of Sydney Water, 16 per cent of Melbourne and the huge 28 per cent of Perth.

This addendum to the Council of Mayors (SEQ) January 2011 submission to the Productivity Commission public inquiry into Australia’s Urban Water Industry is set out as follows:

1. Building the SEQ Regional “*Water Supply Crisis*” (2001-2008)
2. Building the SEQ Household “*Water Price Crisis*” (2008-2018)
3. Update on the politics of water pricing in SEQ
4. The Commission’s ‘Best Practice’ Governance model v SEQ Experience
5. Balancing Public Service with Commercial Principles
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1.0 BUILDING THE SEQ REGIONAL "WATER SUPPLY CRISIS" (2001-2008)

Claims the Queensland Government did not have responsibility for building major regional dams and/or other major bulk water resources are naive and false. For example, in 2006 the State Government boasted about delivering the "*only major dam built by any government in this country in the past decade*".[1] And then, Premier Beattie revealed why it was built: *"My government was responsible for the planning decisions and building Paradise Dam. It was my government that addressed all the environmental issues."*[2]

Additionally, Queensland political history reveals election promises of State Government action on dams and/or other major water supply infrastructure featured very prominently in election strategies for both major political parties in the 2006 and 1989 Queensland State Elections. This is incontrovertible proof the Queensland Government and Queensland Opposition recognise planning, legislative and funding responsibility for regional bulk water supply infrastructure is – and remains – a State Government responsibility.

- **2006 State Election** -one month before the 2009 Queensland General Election was held, the State Government activated the emergency powers of the Water Act, recognising that: *"South East Queensland short and long-term water needs can only be met by a concerted effort on the part of all levels of Government to implement a comprehensive water strategy"*.[3] This – water security – seemingly provided justification and context for an early election.

- **1989 State Election** - Dickie (1994[4]) and Williams (1995[5]) recognise the 1988-89 political campaign to scrap the National Party's proposed Wolfdene Dam helped sweep Labor to power at the 1989 State Election. Novak (2009) argued the SEQ water supply crisis was a product made two decades ago. *"The cancellation of the Wolfdene project ... no doubt proved a popular one amongst the emerging environmental movement. However this decision, which reeked of political opportunism, quickly emerged as a curse bedevilling water policy in Queensland for decades to come."*[6]

Newman and Soorley (2006) argue local governments going back to about 2001 were pushing the State Government to get on and meet the demands of the growing population with new water infrastructure – pointing out the State Government is and always had been responsible to plan for new sources of bulk water.[7] A search of the public record also demonstrates the Queensland Government ignored the foreseeable and cumulative risk to water supply security in SEQ (from 2001). The lack of an appropriate risk mitigation strategy and/or plan for drought in SEQ inevitably helped build the intensity and impact of the SEQ water supply crisis (2005 to 2008),as well as natural disaster (drought) response and recovery actions.

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[1] Beattie, P (the Hon). 2006. 'Water Infrastructure: Motion.' *Queensland Parliament Hansard,* 11 October.
[2] ibid.
[3] Beattie, P (the Hon). 2006. 'Water Supply: Ministerial Statement.' *Queensland Parliament House Hansard,* 8 August.
[4] Dickie, P. 1994. 'Greens turn on Goss.' *The Sunday-Mail*, 27 November.
[5] Williams, B. 1995. 'Veto's Davis slays Eastern Tollway Goliath.' *The Courier-Mail,* 14 September.
[6] Novak, J. 2009. 'Damned decision.' *Institute of Public Affairs: News*, 17 November. Available at: http://www.ipa.org.au/sectors/water/news/2000/damned-decision
[7] Wenham, M. 2006. 'Panic stations – Cabinet to decide on water emergency.' *The Courier-Mail,* 7 August.

The increasing risk of drought and its consequent hardship for SEQ residents and businesses was increasingly evident:

- Queensland Government reports showed average rainfall in the last decade fell nearly 16 per cent compared with the previous 30 years.[8] This is generally consistent with natural variability experienced over the last 110 years, which makes it difficult to detect any influence of climate change;[9]

- The SEQ water supply crisis occurred several years after 'State Government reports recommended the adoption of appropriate risk mitigation actions, especially more sustainable water use practices';[10]

- Government statistics showed the use of fresh water in Queensland doubled between 1983 and 1997 and continued to skyrocket (to 2004);[11]

- The demand for water supply was increasing (population and economic growth), while water supply capacity was decreasing (drought and higher demand). Population growth in Queensland almost doubled in two decades, from 2.6 million in 1986 to 4.4 million in 2009.[12] SEQ had consistently strong population growth rates compared to other major capital city metropolitan areas. More than two thirds of Queensland's population resided in South East Queensland in 2008 (69.2 per cent), compared to 63.3 per cent in 1981;[13]

- States with rapid population growth must spend more to provide the average per capita stock of infrastructure required to deliver the average level of service.[14] With Queensland growing at about twice the national average for a lengthy period, significantly higher levels of infrastructure investment per capita was required, relative to the nation as a whole, to maintain similar levels of service.[15] This is particularly the case for the south east where about 75 per cent of Queensland's growth was taking place;[16] and

- The severity of SEQ's water supply crisis was made worse by delayed State Government intervention, despite early – and regular – warnings from local government 'that SEQ urgently needed a new regional water supply plan'.[17]

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[8] Queensland Government. 2009. 'Climate change impacts on Queensland's regions.' In, *ClimateQ: toward a greener Queensland,* 5.3.10:South East Queensland. P.:43.
[9] ibid
[10] Wardill, S. 2007. 'WATER CRISIS THEY KNEW – State accused of ignoring its own early warning.' *The Courier-Mail,* 7 March.
[11] Fynes-Clinton, J. 2004. 'Crisis won't sink in.' In, *The Courier-Mail,* 19 August.
[12] Queensland Government. 2010. Queensland Growth Management Summit. In, *Background Paper: Opportunities, challenges and choices.* 30-31 March.
[13] ibid
[14] Commonwealth Grants Commission. 'Report on GST Revenue Sharing Relativities – 2010 Review.' *Volume 2 – Assessments of State Fiscal Capacities*.
[15] Morton, A. 2009. 'Federal Road Funding for SEQ.' *Fact Finding Report commissioned by the Council of Mayors (SEQ),* September.
[16] ibid
[17] Stolz, G. 2002. 'Anger at hold-ups in dams strategy.' In, *The Courier-Mail,* 23 November.

2.0 BUILDING THE SEQ HOUSEHOLD "*WATER PRICES CRISIS*" (2008 to 2018)

The recent water supply crisis was a particularly difficult time for SEQ residents and businesses, and residents are still paying for it through higher and increasing State Government bulk water charges. While it appears there has been an end to the last water supply emergency (floods), the biggest issue now facing SEQ is how to pay the reform bill, especially the significant capital costs for diversifying water supply through building and maintaining expensive desalination plants and recycled water schemes.

Premier Peter Beattie described his decision to invest significantly in drought-proofing SEQ in a water security framework: *"Let me be very clear and up-front at the beginning that this water grid is going to, as much as humanly possible, drought proof the south-east corner of Queensland"*.[18] Policy actions to ensure continuity of supply necessarily involved investment in extra capacity (excess to business-as-usual requirements) as a safeguard against future disruptions or emergencies. Less about a commercial objective, this can be viewed as a national water security response providing necessary water supply security against a future natural disaster (drought) for one in seven Australians.

In this context, it is important to note Infrastructure Australia's comparative analysis of annual demand against sustainable yield, which is defined as the long term capacity of a water system to deliver a particular volume of water each year, subject to environmental and infrastructure constraints of the system. For example, Infrastructure Australia (2010) argue buffers have been built up in SEQ and metropolitan Sydney following the recent completion of a range of new supply sources.[19] As shown in the table below, SEQ's supply capacity is now 50 per cent more than the existing annual water demands, providing a buffer of 160,000 megalitres/year. The SEQ Water Grid Manager (2010) argues the State Government's expensive drought-proofing infrastructure has now gone from being 'just in time' to 'just in case'[20].

Water Consumption v Sustainable Yield 2010

CITY/REGION	Annual Demand (GL)	SUSTAINABLE YIELD (GL)	BUFFER/GAP
South East Queensland	320	480	+160
Sydney	480	575	+95
Melbourne	430	387	-43
Canberra	45	44	-1
Adelaide	160	160	0
Perth	286	280	-6

SOURCE: Infrastructure Australia, 2010, P.:18..

However, high debt and borrowings carried forward on major investments in the SEQ Water Grid is directly linked to higher ongoing costs associated with drought mitigation and population growth. Moreover, recent price increases for water and sewerage services throughout urban Australia, including in SEQ, are as much about the lack of an appropriate

[18] Beattie, P (the Hon). 2006. 'Motion: Water Supply.' *Queensland Parliament Hansard*, 9 August.
[19] Infrastructure Australia. 2010. 'Review of Urban Water Security Strategies'. *Report prepared by PriceWaterhouseCoopers*, May.
[20] SEQ Water Grid Manager. 2011. 'Aussie plants go into hibernation.' *News*, 15 December. Available at: http://www.watergrid.com.au/news/16

– all-of-government – response to urban water security, as it is about the relative incapacity of urban water and sewerage utilities to insure bulk water supply and capacity against high natural risks (drought) and population growth. It is also about who will – and how they will – pay the debt and borrowings on the most secure water supply for urban Australia and whether the cost for this insurance policy was a sound investment. In this regard, the Institute of Public Affairs (2011) argues the decision to build extremely high cost sources of supply reflects unfavourably on the political decision takers in Queensland – in the exercise of their judgements or the conduct of their civic responsibilities.[21]

Panic-hurried capital investment in drought-proofing SEQ near the end of the worst drought on record, as well as a unilateral State Government approach to institutional reform, significantly increased disaster response, recovery and long-term drought mitigation costs for Queensland taxpayers and SEQ ratepayers alike. With $7 billion plus of borrowed State Government funds, SEQ has now earned the reputation as having some of the most expensive "white elephants" in water infrastructure in Australia.

- **The $2.5billion Western Corridor Recycled Water Project** (WCRWP) was built in a very big hurry (during drought). The State Government argued *"This recycling scheme is the third largest water recycling project in the world, and I* [Deputy Premier Anna Bligh] *personally believe that we should be using it to its full potential, providing an additional long-term potable water supply for our region".*[22] However, two years later Premier Bligh advised an average storage level of 40 per cent would trigger the addition of recycled water to drinking water supplies**.**[23] And, in December 2010, the State Government announced the Gibson Island and one of the Bundamba recycling plants would be placed on standby mode indefinitely.[24]

  As late as 4 June 2011, *The Courier-Mail* revealed nearly 40 per cent of the 70,000 megalitres of wastewater purified through the scheme since 2007 has been ditched into the river.[25] The 27,000ML would be valued at more than $40 million if sold to council-run retailers at the current wholesale price.[26]

- A year after **the $1.2billion Gold Coast Desalination plant** was meant to be pumping 125 ML/day into the SEQ water supply system, *The Australian* reported it needed repairs and was rusting in sea water. *"The showpiece of a Queensland government strategy to drought-proof the state's booming southeast, the project has been plagued by so many construction flaws and unscheduled shut-downs that the government is still refusing to take possession from the contractors who built it".*[27] Six months later, the desalination plant was again closed (for about three months) for

[21] Institute for Public Affairs. 2011. *Submission to Productivity Commission Inquiry into Australia's Urban Water Sector.* May.
[22] Bligh, A (the Hon). 2006. 'South-East Queensland Water Recycling Plebiscite Bill: Ministerial Statement.' *Queensland Parliament Hansard*, 30 November.
[23] Roberts, G. 2008. 'Queensland Premier Bligh in backflip on recycled water.' *The Australian*, 26 November. Available at: http://www.theaustralian.com.au/news/bligh-backflip-on-recycled-water-plan/story-e6frg6oo-1111118141584
[24] Fraser, A (the Hon) and Robertson, S (the Hon). 2010 'Water reforms save money for householders.' *Ministerial Media Statements*, 5 December. Available at: http://www.cabinet.qld.gov.au/mms/StatementDisplaySingle.aspx?id=72863
[25] Helbig, K. 2011. '$40 million of recycled water 'dumped' into Brisbane River.' *The Courier-Mail*, 4 June. Available at: http://www.couriermail.com.au/news/queensland/million-worth-of-recycled-water-dumped-into-brisbane-river/story-e6freoof-1226068925044
[26] Ibid
[27] Bita, N. 2010. 'Water's quick fix a long-term drain.' *The Australian*, 23 January, Available at: http://www.theaustralian.com.au/news/features/waters-quick-fix-a-long-term-drain/story-e6frg6z6-1225822734703

repairs.[28] And, in late 2010, it was mothballed because of skyrocketing State Government Bulk Water Charges.[29] However, it is expected to return to full-time operation if the region's dam capacity drops to 60 per cent.[30]

- The failed **Traveston Dam proposal** cost valuable time and resources during the emerging SEQ water supply crisis, without producing one drop of water. In context, the State Government publicly announced it would *"invest $25 million to begin preliminary work on a water pipeline from the new Traveston Dam to Brisbane"*[31] about 40 months before the dam was actually approved (with conditions) by the State Coordinator-General. However, the proposed Traveston Crossing Dam proceeded - costing the Queensland taxpayer $461.6 million[32] (including $265 million in non-recoverable expenditure)[33] but was stopped by the Federal Government.

In September 2007, the Deputy Premier directed that the State Government would takeover all Bulk Water and key Water Grid Assets and that the remaining SEQ Council water and sewerage assets be formed into a single distributor and up to 10 retail entities to be established by 1 July 2010.[34] However, the policy direction was later amended (mid-2009), allowing for three Council-owned water and waste distributor-retail entities in SEQ. The State Government decision to scrap its single distributor-retail model evidences a significant flaw in its SEQ water institutional reform policy approach. Consequently, the three SEQ water distributor-retail entities spent almost $67 million setting themselves up before selling a single drop to customers.[35] Additionally, SEQ Councils absorbed the $25 million establishment and de-establishment costs before the State Government's ill-conceived single distributor model was scrapped. And, as directed by the State Government, these establishment costs were to be recovered through increased retail costs.

While SEQ Councils continued to argue the establishment of Corporations Act companies was the preferred model for the distribution-retail entities,[36] the State Government insisted on adopting its political position that "reforms have not, and will not, be driven with labour savings as an aim".[37] In effect, the Beattie-Bligh Government reform model for SEQ's distribution/retail water entities enshrined operational workforce inefficiencies – with efficiencies from greater economies of scale lost because the State Government insisted on three years of job guarantees (on top of three years of job guarantees relating to forced council amalgamations). By way of contrast, Sydney Water report its ongoing efficiency gains in the last three decades were from the elimination of excess staffing (14,000 staff in

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[28] Stolz, G. 2010. 'Tugun desalination facility closed again for repairs.' *The Courier-Mail*, 18 June.
[29] Lion, P. 2010. 'Tugun Desalination Plant to be mothballed, execs face axe in bid to cut water bills.' The Sunday Mail, 5 December, Available at: http://www.couriermail.com.au/news/queensland/tugan-desalination-plant-to-be-mothballed-execs-face-axe/story-e6freoof-1225965891248
[30] ibid
[31] Beattie, P (the Hon). 2006. 'State Government announces funds for water grid.' *Ministerial Media Statements*, 18 July. Available at: http://www.cabinet.qld.gov.au/MMS/StatementDisplaySingle.aspx?id=47256
[32] Lucas, P (the Hon). 2009. 'Traveston Dam cost taxpayers $460m.' In, *The Sunshine Coast Daily* (AAP Newswire) 7 January, available at: http://www.sunshinecoastdaily.com.au/story/2009/01/07/traveston-dam-cost-taxpayers-460m/
[33] Robertson, S (the Hon). *Answer to Question on Notice No. 1803 from Steve Dickson MP*: Asked on 12 November 2009. Queensland Parliament Hansard, available at: http://parlinfo.parliament.qld.gov.au/isysquery/c1bb68f0-c6a4-4065-8008-9eb679c30d5e/1/doc/1803-2009.pdf#xml=http://parlinfo.parliament.qld.gov.au/isysquery/c1bb68f0-c6a4-4065-8008-9eb679c30d5e/1/hilite/
[34] Bligh, A (the Hon). 2007. Letter to Council of Mayors (SEQ) Chairman. 4 September.
[35] Wardill, S. 2010. 'Water retailers spent almost $67 million before selling a single drop to customers.' In, *The Courier-Mail*, 1 December. Available at: http://www.couriermail.com.au/news/queensland/water-retailers-spent-almost-67-million-before-selling-a-single-drop-of-water-to-customers/story-e6freoof-1225963524404
[36] Rankin, S. 2008. Letter to Executive Director Water Reform – Queensland Water Commission (Peter Dann) from Council of Mayors (SEQ) Water Reform Program Director (Susan Rankin). 11 November.
[37] Bligh, A. (the Hon) 2007. Letter to the Council of Mayors (SEQ) from the Deputy Premier, Treasurer and Minister fro Infrastructure. 4 September.

1980 to 2,978 in 2009-10), rationalising non-core business activities and increased private sector involvement, including extensive use of the private sector to deliver services.[38]

Infrastructure Australia (2010) point to a confusing Queensland Government pricing policy, which caps the State bulk water price at a four per cent pre-tax target rate of return on newly constructed "drought" assets, while targeting a commercial rate of return on the majority of bulk water, which is sourced from existing assets and otherwise new capital.[39] Figure 1 (below) represents the outcome of the State Government's reforms on an average household water bill (200KL) in Brisbane. It is based on the Queensland Water Commission's 10-year bulk water price path (to 2017-18), actual access and service charges (retail) for 2007-08 to 2010-11 and the proposed legislative price cap from 2011-12 to 2012-13, which will not apply to the State Government Bulk Water Charge. Curiously, unlike SEQ distribution-retailer price-setting, the State Government's Bulk Water Prices have not been subjected to "independent review" – or a review by the Queensland Competition Authority (QCA). Not surprising, many people view the State Government's politically-charged takeover of council-owned bulk water supply assets as *"...a cynical ploy to shift costs to councils and blame them for price hikes"*.[40]

The State Government Bulk Water Charge (State Water Tax) has increased significantly since 2007. When it announced its unilateral institutional reform of SEQ's water supply, the Queensland Government sold it as: *"We're in the middle of the most exciting period of development in the State's history and we have clearly outgrown a water delivery system that belongs in the horse and buggy days."*[41] It is important, however, to recognise, that, while the SEQ water supply crisis acted as a catalyst for institutional reform for the region's water supply system, the crisis was primarily about capacity and demand issues – diminishing bulk water supply capacity, the lack of alternative water sources, wasteful water use practices and increasing demand from population and economic growth.

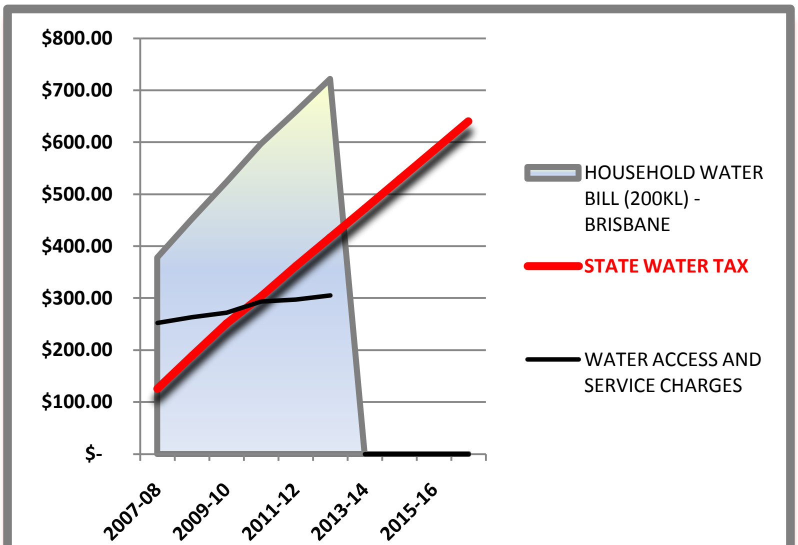

Figure 1 Brisbane Water Bill (200KL) - 2007-08 to 2017-18

Increases in the State Government Bulk Water Charge were the key cost driver for each of SEQ's three distributor-retailer companies in 2010-11: Queensland Urban Utilities (83.8%); Allconnex (61.7%) and Unitywater (34.5%).[42] Figure 1

[38] Sydney Water. 2010. 'Australia's Urban Water Sector.' *Submission to Productivity Commission Public Inquiry*, November.
[39] Infrastructure Australia. 2010. 'Review of Urban Water Security Strategies'. *Report prepared by PriceWaterhouseCoopers*, May.
[40] Houghton, D. 2010. 'Labor, like a cliché, is all worn out.' In *The Courier-Mail*, 4-5 December.
[41] Bligh, A (the Hon). And Beattie, P (the Hon). 2007. 'Beattie Government responds to pricing recommendations.' *Queensland Government Ministerial Media Statements*, 9 March. Available at: http://www.cabinet.qld.gov.au/MMS/StatementDisplaySingle.aspx?id=50788
[42] Cousins, D. 2010. 'Review of Water Prices.' *Final Report* (commissioned by the Council of Mayors (SEQ) Pty Ltd), December.

also shows Queensland's State Water Taxes will continue to drive up average household water bills. On average, bulk water costs have been growing at the rate of 28.9% per annum, while distribution/retail costs have been growing at the rate of 10.7% per annum.[43] The State Government Water Taxes have increased in prominence as a proportion of the total retail water bill in recent years (since 2007-08) and are expected to account for almost two-thirds of the total retail water bill in 2017-18.[44]

The Council of Mayors (SEQ) believe that, with the last water supply emergency now behind us, it is an opportune time for a truly independent review of the timing, scale, scope, management and significant cost of drought-proofing investment decisions in SEQ. It is important to review – and improve – what was panic-hurried policy development and institutional reform for SEQ's urban water sector, which remain the legacy of a potentially avoidable natural supply emergency and desperately urgent water security response, recovery and risk mitigation approaches. Furthermore, because of the significant cost-of-living pain associated with the skyrocketing State Government Bulk Water Charge, a detailed review of how the State Government can pay down, or write off, debt on drought-immune water assets is necessary. It is also recognised that the Queensland Water Commission (QWC) is not fully independent of government.[45]The politicisation of the QWC, coupled with its lack of independence from the State Government, has eroded "outsider" confidence in its capacity to provide independent and objective advice.

[43] AECGroup. 2010.'Assessment of Drivers of Recent Water Price Increases in SEQ.' *Final Report* (Commissioned by the LGAQ), November.
[44] AECGroup. 2010.'Assessment of Drivers of Recent Water Price Increases in SEQ.' *Final Report* (Commissioned by the LGAQ), November.
[45] Infrastructure Australia. 2010. 'Review of Urban Water Security Strategies'. *Report prepared by PriceWaterhouseCoopers*, May.

3.0 UPDATE ON THE POLITICS OF WATER PRICING IN SEQ

The second public hearings for the Productivity Commission's public inquiry into Australia's Urban Water Sector occur at a time when Queensland Parliament is considering draft legislation – '*The Fairer* [sic] *Water Prices for SEQ Amendment Bill 2011'* (FWPAB) - that will force SEQ water and waste distribution-retail companies to abandon the Council of Australian Government (COAG) commitment to National Water Initiative (NWI) pricing principles. This is despite the fact that the Queensland Government is a signatory to the NWI, which requires metropolitan pricing to move towards 'upper bound pricing' by 2008. The State Government was also a signatory to the National Competition Policy Agreements of COAG, most recently the 2006 agreement, which states that prices for GOCs *"...should be set so as to generate expected revenue for a regulated service that is at least sufficient to meet the efficient costs of providing access to the regulated service or services and include a return on investment commensurate with the regulatory and commercial risks involved."*

The Queensland Government's recent political decision undermines past, present and future COAG water reform agreements about national competition policy and retail pricing-setting principles more broadly. As a result of recent political decisions, the State Government's recent representation to the Productivity Commission that "*urban water pricing policy is consistent with the NWI and recently endorsed NWI pricing principles that support best practice pricing, including full cost recovery where practicable, consumption based charges, user pays and price transparency"*[46] is false. Importantly, there is no regulatory "carrot and stick" for compliance with NWI pricing principles, which seemingly makes an agreed COAG pricing policy meaningless.

As recorded in its first (January 2011) submission to the Commission, the Council of Mayors (SEQ) can report the Queensland Government remains fiercely critical of council-owned water distribution-retail companies, claiming they should not make a 'profit' from investments in water and sewerage businesses. This is despite the fact the State makes a 'profit' out of its rural water company Sunwater, as well as from its electricity companies and out of its other Government-Owned Corporations (GOCs). In context, IPART (2010) point out the water industry is more capital intensive than the electricity industry and the monopoly components comprise a more significant component of the industry's costs.[47]

Current State Government policy to cap retail water and sewerage prices at 3.6 per cent in 2011-12, while State Government Bulk Water Charges increase between 14 and 30 per cent for SEQ households, is also inconsistent with State Government practice on price-setting for State Government electricity prices. For example:

- 2011-12 Electricity Price Increase (retail) - Minister Robertson (2011):- 6.6 per cent retail bill increase *"Today's 6.6% announcement by the QCA is higher than originally*

[46] Department of Environment and Resource Management. 2010. 'Productivity Commission Issues Paper: September 2010 Australia's Urban Water Sector.' *Submission,* 15 November.
[47] Independent Pricing and Regulatory Tribunal (NSW). 2010.'Submission to Inquiry by Productivity Commission to Australia's Urban Water Sector.' November.

forecast and unfortunately means Queenslanders will pay more for their electricity from 1 July 2011"[48];

- 2010-11 Electricity Price Increase (retail) -13.29 per cent - Minister Robertson: *"if I were to intervene and reduce these prices then it would mean a reduction in investment in our electricity system...We would return to the days of blackouts and brownouts - an unreliable electricity system that caused so much angst and anger in the early part of this decade";*[49] and

- 2009-10 Electricity Price Increase (retail) -11.82 per cent - Minister Robertson: *"the regulated electricity price is set by independent experts to cover the costs of generating, distributing and retailing electricity. If the price is set below that cost, the network will not be able to keep up with demand for electricity and reliability will be compromised"*[50]

The State Government claim the FWPA Bill was introduced "in direct response to the South-East Queensland community calling for the government to take action against the high water and waste water prices being charged by councils and the council-owned distributor retailers".[51] This is nonsense. *The Courier-Mail* observed: *"The irony of it is impossible to ignore – the State Government spent nearly $7billion drought-proofing the region just in time for the wettest summers on record...not only is the new water system exceedingly expensive but it is also extremely confusing. Perhaps that's just what the Government wanted, a way to spread the blame."*[52]

The *'Fairer* [sic] *Water Prices for SEQ Bill'* currently before the State Parliament fundamentally breaches the National Water Initiatives and the Competition and Infrastructure Reform Agreement 2006 by capping council water charges to inflation for two years. The Table (opposite) shows the outcome of the proposed FWPAB. Noticeably, while retail water prices will be capped at CPI for two years, the State Government's Bulk Water Charges will increase from between 27 per cent in Somerset and 60 per cent in Redlands.

[48] Robertson, S (the Hon) 2011. 'Minister disappointed at QCA electricity pricing decision.' *Ministerial Media Statements*, 31 May. Available at: http://www.cabinet.qld.gov.au/mms/StatementDisplaySingle.aspx?id=75003
[49] Calligerons, M. 2010. 'Minister can, but won't, veto power hike.' In, *BusinessDay*, 29 May. Available at: http://www.businessday.com.au/business/minister-can-but-wont-veto-power-hike-20100528-wk7s.html?comments=29
[50] Robertson, S (the Hon). 2009. 'Ministerial Statement: Electricity Prices.' *Queensland Parliament Hansard*, 22 April.
[51] Robertson, S (the Hon). 2011. 'Fairer Water prices for SEQ Amendment Bill: First and Second Reading.' *Queensland Parliament Hansard*, 12 May. Available at: http://www.parliament.qld.gov.au/view/legislativeAssembly/Hansard/documents/2011.pdf/2011_05_12_DAILY.pdf
[52] Fagan, D. 2010. 'Water saga has now become an expensive fiasco.' In, *The Courier-Mail*, Editorial, 7 December.

SEQ HOUSEHOLD WATER BILLS WITH NEW STATE GOVERNMENT LAW							
	2011-12			2012-13			
LGA	WATER BILL (200KL)	STATE WATER TAX	WATER TAX INCREASE SINCE 2010-11 (%)	WATER BILL (200KL)	STATE WATER TAX	WATER TAX INCREASE since 2010-11 (%)	STATE WATER TAX INCREASE SINCE 20120-11 ($)
BRISBANE	$597	$361	19%	$722	$417	37%	$113
IPSWICH	$772	$348	20%	$854	$404	39%	$113
SCENIC RIM	$868	$422	16%	$931	$478	31%	$114
LOCKYER VALLEY (Gatton)	$769	$400	17%	$785	$456	33%	$114
SOMERSET	$751	$476	14%	$863	$532	27%	$115
GOLD COAST	$728	$395	17%	$867	$451	34%	$114
LOGAN (north)	$780	$427	16%	$920	$483	31%	$114
REDLAND	$581	$243	30%	$717	$298	60%	$112
MORETON BAY	$698	$389	18%	$835	$444	34%	$113
SUNSHINE COAST	$542	$271	27%	$675	$326	52%	$112
SOURCE: AECGroup (2011), QUU (2011) , QWC (2010) and Queensland Government (2011)							

The National Water Commission (NWC) said it was disappointing that the Queensland Government had chosen to step back from reforms and impose a short term price cap on SEQ water and sewerage charges. The NWC said: *"Flexible pricing options would give customers more choice and better signal the value of our water. It is equally important that pricing is overseen by fully independent economic regulators...A better way forward for the Queensland Government would be to have an independent economic regulator to oversee water prices"*.[53] As the Queensland Government Bulk Water Charges are the major cost driver for increasing household and business water bills in South East Queensland, independent oversight for price-setting of State Government Bulk Water Charges is necessary. Importantly, the New South Wales and Victorian State Governments do submit all bulk water pricing and financial models for review by their relevant independent statutory competition authorities.[54] Counter claims by the Queensland Government that it has been "open and transparent" about its 10-year Bulk Water Price path 'because it was set and

[53] National Water Commission. 2011. 'National Water Commission calls for a rethink on water prices.' Media Release, 20 April. Available at: http://www.nwc.gov.au/www/html/3035-rethink-on-water-pricing.asp?intSiteID=1
[54] Hallam, G. 2011. Letter from the Local Government Association of Queensland to the Minister for Finance and the Arts, Hon Rachel Nolan MP. 19 May.

published by the Queensland Water Commission' are spurious. The QWC is not considered independent of the State Government.[55]

The Queensland Government's political decision to cap retail water prices at CPI for two years will also have a significant impact on the SEQ water distributor-retailers significant capital works program, which (combined) was estimated at about $2.91billion from 2010-11 to 2012-13. Substantial increases in capital expenditure were proposed by the entities in future years.[56] In addition to the removal of State Government capital subsidies for new water and wastewater infrastructure, this will also act as a disincentive for SEQ retail-distribution entities to invest in infrastructure and innovation outside a commercial risk profile. Water Services Association of Australia (2010), for example, observed that the absence of subsidies combined with the lower rate of return on certain 'drought response' assets act as a disincentive for SEQ's newly formed distributor-retailer authorities to consider local wastewater recycling and potable substitution options even though they might be economic from a broader, whole-of-grid perspective.

The removal of the Queensland Government capital works subsidy scheme for water and sewerage schemes would ordinarily mean that infrastructure charges would need to increase further to ensure appropriate cost recovery.[57] However, since its earlier submission to the Commission, the Council of Mayors (SEQ) regrettably advise the State Government has now capped infrastructure charges at $20,000 for 1-2 bedroom dwellings and $28,000 for 3-4 bedroom dwellings. This will have a significant impact on Council and water utility companies' capacity to deliver water and sewerage infrastructure and services to cater for population growth.

The Council of Mayors (SEQ) concerns are justified by warnings to the Queensland Government through its 2007 South East Queensland Water Sector Asset Audit that: "*strategies to ensure the consolidated business can continue to levy developer/infrastructure charges, or to otherwise replace this revenue stream, will be critical to its future financial performance*".[58] Additionally, recent Queensland Treasury Corporation (QTC) modelling showed the adoption of the maximum infrastructure charges proposed by the Queensland Government will create an unfunded liability of the order of $500 million per annum across SEQ.[59] *Based on AEC Group modelling, this is likely to be around $700 million per annum when extended to all high-growth Local Governments across Queensland which equates to around $400 per ratepayer per annum*.[60]

The significant and increasing cost associated with the State Government Bulk Water Charge is major upward-driver of operational costs for SEQ water distribution-retail entities, which in turn is causing significant cost-of-living pain for SEQ households and small businesses. Consequently, major increases in household water bills are an ongoing 'hot

[55] Infrastructure Australia. 2010. 'Review of Urban Water Security Strategies'. *Report prepared by PriceWaterhouseCoopers*, May.
[56] Queensland Competition Authority. 2011. *SEQ Interim Price Monitoring.* Final Report, Part A – Overview, March. Available at: http://www.qca.org.au/files/W-QCA-SEQInterimPriceMonitoring201011FinalReportPartAOverview-0311.pdf
[57] ibid
[58] PriveWaterHouseCoopers. 2007. 'South East Queensland Water Sector Asset Audit.' *Report commissioned by the Queensland Water Commission*, April.
[59] AECGroup. 2011. 'Impact of Maximum Infrastructure Charges on Queensland High Growth Councils'. *Report Commissioned by LGAQ*, April.
[60] ibid

politics' issue for the Queensland Government and SEQ Councils. In this context, Cousins (2010) observed: *"The State Government has indeed shown every indication of wanting to distance itself from responsibility for large price increases associated with the new drought proofing investments. It has sought to stand behind the QWC and, rather than point to the distributor-retailers, it has sought to 'lay blame' on local governments for not exercising restraint on retail prices."*[61]

State Government claims that SEQ distribution-retail companies were "profiteering" from ratepayer assets are simply not supported by Queensland's statutory independent competition regulator, or independent research and financial modelling commissioned by the Council of Mayors (SEQ) and the Local Government Association of Queensland. In its final review of SEQ 2010-11 water prices (retail) for example, the Queensland Competition Authority found *"as revenues* [for distributor- retailers] *in 2010/11 do not significantly exceed the MAR based on the available information, there is no evidence of an exercise of monopoly power in 2010/11."*[62]

All SEQ Council budgets are publicly available and every cent of their revenue, whether rates or returns, goes into providing services for their community. Any return in dividends for ratepayer-owned water utilities is put back into the community through investments in libraries, water, sewerage and drainage infrastructure, waste services, local roads, footpaths, local parks, sporting fields and public transport, etc. This is consistent with claims made by Minister Lucas, when talking about dividends from State Government-owned electricity companies, that: *"...a major reason why we own these utilities is for them to make a return in dividends to taxpayers which we put back into our schools, our hospitals and police"*.[63]

The Table below provides the latest capital city data set taken from the National Water Commission's *2009-10 National Performance Report for Urban Water Utilities*. This provides a sound comparative analysis that shows Brisbane had the second lowest water price of any capital city, despite the highest operating costs and the lowest profits. Brisbane had the highest increase in operational costs primarily because of the State Government's massive bulk water price increases. Indeed, the Queensland Competition Authority found that, for Brisbane City Council in 2009-10, *"total revenues were below those necessary to achieve full cost reflectivity".*[64]

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[61] Cousins, D. 2010. 'Review of Water Prices.' *Final Report* (commissioned by the Council of Mayors (SEQ) Pty Ltd), December.
[62] Queensland Competition Authority. 2011. *SEQ Interim Price Monitoring.* Final Report, Part A – Overview, March. Available at: http://www.qca.org.au/files/W-QCA-SEQInterimPriceMonitoring201011FinalReportPartAOverview-0311.pdf
[63] Lucas, P (the Hon). 2004. "Springborg caught out.' *Ministerial Media Statements*, 4 February. Available at: http://www.cabinet.qld.gov.au/MMS/StatementDisplaySingle.aspx?id=23635
[64] Queensland Competition Authority. 2009. 'Retail Price Monitoring in SEQ Urban Water Sector: Brisbane City Council.' *Final Report*, October. Available at: http://www.qca.org.au/files/W-SEQretailprice-QCA-BCCFinalRep09-1109.pdf

2009-10 National Performance Report

Urban Water Utilities

CAPITAL CITY	Average Use (K/l)/property	Typical Bill	Operational Cost/Property	Net Profit $M	NPAT ratio (%)	DIVIDEND $M
BRISBANE	143	$836	$639	85.7	12%	58
Sydney	205	$985	$556	488.9	21%	263
Melbourne	142	$627	$579	357.7	16%	185
Perth	276	$974	$479	538.4	28%	417
Adelaide	191	$867	$436	190	18%	169
Canberra	199	$923	$710	30	13%	31

SOURCE: National Performance Report 2009-10: Urban Water utilities

On average, the need to recover the increased costs associated with the Queensland Government bulk water charges has accounted for two thirds of recent price increases.[65] Therefore, a State Government policy decision aimed at reducing the price impact of household water bills by implementing a CPI-cap on retail prices for SEQ household water bills without addressing the major driver for skyrocketing household water bills – the State Government Bulk Water Charges – is simply disingenuous.

[65] AECGroup. 2010.'Assessment of Drivers of Recent Water Price Increases in SEQ.' *Final Report* (Commissioned by the LGAQ), November.

4.0 THE 'BEST PRATICE' GOVERNANCE MODEL v SEQ EXPERIENCE

The Commission's draft report rejects price regulation of water, arguing that good governance in a proper formal corporate environment would deliver more efficient pricing outcomes. This was experimented in South East Queensland. And, the State Government did not let it last one year.

The three retailer-distributors were each required by law to be commercially focused, to deliver investment programs to meet the growth targets set by the South East Queensland Regional Plan (SEQRP). They were each subject of Participation Agreements which set out in detail how profits were to be determined and paid - and were subject to prices monitoring by the QCA. Each distributor-retailer entity had independent commercially focused boards. And, they were subject to the pricing provisions of National Competition Policy, and the financial policies set by Queensland Treasury, which required each of the three entities to move towards 'commercial grade' credit worthiness to secure BBB+ borrowing status.

The Council of Mayors (SEQ) would have liked them to be Corporations Law companies, but the State Government declined so as to keep their 3000 workers out of the Federal industrial relations system, and, instead, established them as 'company like' statutory entities with similar powers and responsibilities. The entities were to set their own prices for three years under this framework, subject to oversight by the QCA. And, the QCA consistently found no evidence of abuse of monopoly power by Council-owned water entities. In short, they were operating in an environment very similar to that recommended by the Productivity Commission. It lasted less than a year.

The Queensland Government, who has presided over huge increases in Energy Prices and collects $560m in dividends and tax equivalents from State energy companies, refused to allow the Council Water companies to set prices for their second year. It has now imposed a price cap which will strip around $100m this year and $200m next year out of the water companies revenue. The northern and southern distribution-retail entities now cannot reach commercial grade investment status required by State Treasury. They now cannot meet the requirements of the Participation Agreements signed off by the Minister last year. And, they cannot fund the full capital programs needed to ensure that the entities can keep pace with population growth in SEQ.

The Council of Mayors (SEQ) notes the Commission draft recommendation (11.1): "*Retail–distribution utilities should be assigned responsibility for meeting security of supply standards and procuring water supply and services."* This is consistent with the Weller Review (2009:86) which argued that Governments "certainly" need to control the supply of and delivery of water, either directly, or through authorities. Local services should be delivered at a suitably appropriate local level and there should be flexibility of form and process, depending on local conditions.[66] Attached as ***Appendix A*** is the original submission the Council of Mayors (SEQ) sent to the State Government following the

[66] Webbe, S., and Professor Patrick Weller AO. 2009. 'Brokering Balance: A Public Interest Map for Queensland Government Bodies.' *An Independent Review of Queensland Government Boards, Committees and Statutory Authorities* (Commissioned by the Department of Premier and Cabinet), Part B, March.

release of the Weller Review. Yarra Valley Water (2010) also made a strong case that water utilities responsible for customers should hold bulk water entitlements on their behalf and these customer-focussed water utilities should manage their own water-supply demand balance in accordance with obligations reflecting central, larger scale plans.[67]

For SEQ Councils and Council-owned water distributor-retail entities, the experience of the last two years of dealing with the State Government has been that of irrational policy back flips on water prices and polices. Frustratingly, councils will be punished with reduced dividends, reduced investments in water and other desperately needed infrastructure, and the longer term consequences of the damage to the reputation of its water entities.

The State Government in its actions has fundamentally breached its commitments under the NWI, NCP and COAG. The National Water Commission has slammed its performance, the state's own economic regulator the QCA has been sidelined and ignored, and the agreements the State Government had with Councils to establish good governance of the water companies swept aside. This has been a victory of political point scoring over common sense.

The Council of Mayors (SEQ) has supported full price regulation of water prices in SEQ. It believes that such an approach would be far preferable to political interferences in rational pricing decisions by the State Government for cheap political points, when this comes at the expense of the longer term economic viability and investment by water utilities. Multi billion dollar public water companies should not be the political play thing of State Governments. National Completion Policy, the National Water Initiatives and COAG's processes were about preventing that. In Queensland, these reforms are going backwards.

[67] Yarra Valley Water. 2010. 'Australia's Urban Water Sector.' *Submission to Productivity Commission Public Inquiry*, November.

5.0 BALANCING PUBLIC SERVICE WITH COMMERCIAL PRINCIPLES

On 28 July 2010, the United Nations General Assembly adopted a resolution recognising access to clean water and sanitation as a human right. While the Australian Government abstained from the vote, it linked access to water and sanitation to a range of civil rights.[68] The availability of reliable and affordable water is fundamental to maintaining a high living standard for all Australians and is a critical enabler of economic activity in Australia's metropolitan and regional areas.[69] In this context, all levels of government have a responsibility to learn from the past – and provide urban Australia with better water security. *"South East Queensland's short and long-term water needs can only be met by a concerted effort* [and investment] *on the part of all levels of Government to implement a comprehensive water strategy"*.[70]

For Australia, access to safe water and sanitation services is as dependent on climatic and seasonal variations (drought and flood) – as it is on the infrastructure and technology that will make (desalination and recycled water), collect (waterways), store (dams), treat (water and wastewater treatment) and distribute (distribution and retail) clean water and sanitation services. From an historic analysis, both climatic risk profiles - drought and flood - have long been linked as the extreme, albeit not infrequent, parts of the same climate-vulnerable national landscape. This is as relevant a consideration to the urban water supply network, as it is for most other water supply systems throughout Australia. In SEQ, for example, Wivenhoe Dam's primary function is to provide a safe and reliable water supply (1.15 million megalitres) for the region, but it is also designed to hold back a further 1.45 million megalitres in the event of a major flood. Indeed, one of the issues discussed in the Holmes Queensland Floods Commission of Inquiry was how to strike the right balance between flood mitigation and water security.[71]

A reliance on lowest cost surface water dominated collection methods throughout Australia, especially dams, means a high reliance on rainfall and inflows. This highlights the potential conflict between the dual roles of flood mitigation and security of supply, especially through the adoption of a fiscal imperative in the management of dams as publicly-owned commercial assets – full cost reflectivity. Similarly, investment decisions to ensure continuity of supply (during drought) may involve investment in extra capacity that may be excess to business-as-usual requirements but would be needed during disruptions (flood) or emergencies (drought).[72]

Having recognised drought as a significant and increasing national risk for urban water supply security – with consequent hardship for urban Australia – an adequate approach to national reform cannot simply bespoke national commercial principles for urban water suppliers and its customers, while leaving the significant cost of drought-proofing the national urban water supply to state and local governments. Actions taken to ensure

[68] United Nations General Assembly. 2010. 'General Assembly Adopts Resolution Recognising Access to Clean Water, Sanitation as Human Right, By recorded Vote of 122 in Favour, None Against, 41 Abstentions.' In, *Sixty-fourth General Assembly Plenary*, 108th Meeting, 28 July.
[69] Infrastructure Australia. 2010. 'Review of Urban Water Security Strategies'. *Report prepared by PriceWaterhouseCoopers*, May.
[70] Beattie, P (the Hon). 2006. 'Water Supply: Ministerial Statement.' *Queensland Parliament House Hansard*, 8 August.
[71] Woolley, B. 2011. 'Pisasale urges Wivenhoe to focus on flood mitigation.' *ABC News*, 14 April, available at: http://www.abc.net.au/news/stories/2011/04/13/3190793.htm
[72] Productivity Commission. 2010. 'Annual Report 2009-10.' *Annual Report Series*, Appendix A (Recent Developments in Australia's Productivity). October.

continuity of supply may decrease measured productivity if they increase capital without any commensurate increase in output.[73] The recent experience in South East Queensland suggests a commercial price path for a high level of "water security" is beyond the affordability of many Australians and beyond the political and economic capacity of state and local governments.

It is important to recognise that these major investments in urban desalination and recycled water projects could provide important long term insurance against a natural and recurring risk for the SEQ urban water supply – climate (drought). In this context, policy actions to ensure continuity of supply necessarily involved investment in extra capacity (excess to business-as-usual requirements) as a safeguard against future disruptions or emergencies. Less about a commercial objective, this can be viewed as a longer-term national security response providing necessary water supply security against a future natural disaster (drought) for one in seven Australians.

High debt and borrowings carried forward on major investments in the SEQ Water Grid is directly linked to higher ongoing costs associated with drought mitigation and population growth. Moreover, recent price increases for urban water and sewerage services throughout Australia, including in SEQ, are as much about the lack of an appropriate – all-of-government – response to urban water security, as it is about the relative incapacity of urban water and sewerage utilities to insure bulk water supply and capacity against high natural risks (drought) and population growth. There is strong evidence that population growth is a major driver of State infrastructure spending and States with rapid population growth must spend more to provide the average per capita stock of infrastructure required to deliver the average level of service.[74]

The Council of Mayors (SEQ) believe it would be entirely consistent with the objectives of a national urban policy for all levels of government, especially the Commonwealth, to play a greater role in ensuring all Australian citizens, including the majority of Australians who live in urban areas, have access to a safe, secure and, just as importantly, "affordable" urban water and sewerage services. This also points up the potential economic, social and environmental dividends for Commonwealth and State Governments through national urban reforms that link financial incentives for innovative local water and wastewater infrastructure to raising national efficiency, productivity and environmental outcomes.

[73] Productivity Commission. 2010. 'Annual Report 2009-10.' *Annual Report Series*, Appendix A (Recent Developments in Australia's Productivity). October.
[74] Commonwealth Grants Commission. 'Report on GST Revenue Sharing Relativities – 2010 Review.' *Volume 2 – Assessments of State Fiscal Capacities*.

6.0 RECOMMENDATIONS

The Council of Mayors (SEQ) makes the following recommendations to the Productivity Commission's public inquiry into Australia's Urban Water Sector:

1. **The availability of reliable and affordable water is fundamental to maintaining a high living standard for all Australians and is a critical enabler of economic activity in Australia's metropolitan and regional areas.** Access to water and sanitation is linked to a range of civil rights and is now recognised by the United Nations as a fundamental Human Right. From an historic analysis, both climatic risk profiles - drought and flood - have long been linked as the extreme, albeit not infrequent, parts of the same climate-vulnerable national landscape. Investment decisions to ensure continuity of supply (during drought) may involve investment in extra capacity that may be excess to business-as-usual requirements but would be needed during disruptions (flood) or emergencies (drought).

2. **It would be entirely consistent with the objectives of a national urban water policy for all levels of government, especially the Commonwealth, to play a greater role in ensuring all Australian citizens, including the majority of Australians who live in urban areas, have access to a safe, secure and, "affordable" urban water and sewerage services.** This also points up the potential economic, social and environmental dividends for Commonwealth and State Governments through national urban reforms that link financial incentives for innovative local water and wastewater infrastructure to raising national efficiency, productivity and environmental outcomes.

3. **There is a need to recognise and clarify public policy objectives and principles about the potential conflicts that arise between water supply security, flood mitigation and healthy waterways**. A reliance on lowest cost surface water dominated collection methods throughout Australia, especially dams, means a high reliance on rainfall and inflows. This highlights the potential conflict between the dual roles of flood mitigation and security of supply, especially through the adoption of a fiscal imperative in the management of dams as publicly-owned commercial assets.

4. **Water entities, both State and Local Government controlled, should be subject to National Competition Policy, and to public scrutiny by a State and possibly a National economic regulator.** All three SEQ Council-owned water distribution-retail companies have been twice found by the QCA to be operating within Maximum Allowable Revenue and not overcharging prices. By contrast, the State Government has never been subject to such scrutiny on its bulk water prices. A recent analysis commissioned by the LGAQ found that the State was probably accelerating depreciation allowances and applying an exceptionally high rate of return on assets. The State disputed these findings, but refused local government request to open its books for independent scrutiny.

5. **Require the State Government be held fully accountable for meeting their agreed national commitments under the NWI and NCP.** The Council of Mayors (SEQ) has supported full price regulation of water prices in SEQ. It believes that such an approach would be far preferable to political interferences in rational pricing decisions by the State Government for cheap political points, when this comes at the expense of the longer term economic viability and investment by water utilities. Multi billion dollar public water companies should not be the political play thing of State Governments. National Completion Policy, the National Water Initiatives and COAG's processes were about preventing that. In Queensland, these reforms are going backwards. There is no regulatory "carrot and stick" for compliance with NWI pricing principles, which seemingly makes an agreed COAG pricing policy worthless.

6. **Water entities capital investment should be closely aligned with land use planning and growth targets set by councils and State Governments.**

7. **Water and Sewerage entities should have access to reasonable income streams to fund capital growth.** The State Government has also announced capping of infrastructure charges and removed capital works subsidies, which makes it more difficult to deliver the infrastructure and services necessary to meet existing and future growth.

8. **Water entity structures should be simple.** SEQ currently has four entities dealing with State bulk water – one owns the dams, one the manufactured water, one the pipelines and one manages the contracts. Each has its own board and its own team of well paid executives. Councils have long viewed this structure as a waste of money and believe a singe bulk water entity, subject to independent price monitoring, should be established. *Appendix A* may provide some guidance.

9. **Water and sewerage retail-distribution functions should be closely aligned to councils where reasonable economies of scale can be established**. SEQ has four of the five largest councils in Australia, with 11 councils representing 3 million people. Our larger councils had already established reasonable economies of scale in their water businesses with greater than 100,000 connections in four council water businesses by 2009, and with two others set to cross that threshold by 2020. Some studies suggest that economies of scale dissipate with larger water utilities, such as the size of Sydney Water. Given the close planning relationship between council land-use planning functions and water utility infrastructure roll outs, benefit in aligning utility and council boundaries in SEQ that may outweigh any further benefit from economy of scale.

10. **The Council of Mayors (SEQ) strongly supports the Productivity Commission view that water entities should be subject to good governance, clearly specified investment agreements and expectation and best practice pricing principles.** Given the bitter experience with the capriciousness and hypocrisy of State Governments and their differing approaches to regulation of water and energy

companies, SEQ councils support full price regulation of water entities as a means of providing a degree of separation from political and pricing pressures.

11. **Council of Mayors (SEQ) disagrees with the Commission's approach to water efficiency and water restrictions**. SEQ is the biggest petri dish in the world when it comes to water efficiency and water restrictions. The real life experience of SEQ is more relevant to this debate than the loose economic models and papers that the Commission appears to be relying on to reject behavioural approaches.

    Prior to the recent drought, in 2004-05, SEQ households were using on average 282 litres of water per person/day, compared to 215 in Sydney and 195 in Melbourne. By 2008-09 this had fallen to 143 litres per person/day. Even with the removal of water restrictions, consumption had crept up to only around 160-180 litres per person/ day. There have been permanent changes in behaviour in SEQ. These are for the better.

    In 2004-05 over half of all water in the home was used in watering lawns. Over the last five years, we have changed fundamentally our approach to the types of lawns and gardens we plant, saving millions of litres. We would commend this experience to the Commission.

8 April 2009

Council of Mayors
South East Queensland

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Hon Anna Bligh MP
Premier and Minister for the Arts
PO Box 15185
BRISBANE QLD 4001

Dear ~~Premier~~ Anna,

I am pleased to provide the Council of Mayors (SEQ)'s response to the Weller Review's proposals on the water entities in South East Queensland. With the water crisis easing, we broadly endorse the recommendations of the Weller Review that there are too many water entities in South East Queensland (SEQ), with unnecessary costs and fractured accountabilities as a result.

While the Government has, to date remained committed to the water institutional reforms proposed by the Queensland Water Commission (QWC) in May 2007, the Council of Mayors (SEQ) believe that it is an appropriate time to reflect on whether the model remains the best way forward. Since May 2007, there have been four major reviews of water entities interstate, in New South Wales, Victoria, Western Australia and Tasmania. No other state has followed the QWC's approach, identifying little benefit in shifting from a water structure with typically one or two entities to the seven-level structure proposed by the QWC.

The Council of Mayors (SEQ) submission draws from the various interstate reviews to highlight the lack of economic analysis underpinning the QWC's case for a single distribution entity and three fully contestable retailers. Applying the findings of the reviews to Queensland suggest that Brisbane Water and Gold Coast Water are already running at an adequate economy of scale – a view confirmed by the National Water Commission's Urban Water Utilities Performance Report released last week. Council amalgamations provide the basis for achieving economies of scale in other councils.

Three other factors detailed below should also give the Government pause for thought on whether the next phase of water reform should proceed.

Cost of the reform process
The cost of establishing a new distribution entity and three retailers capable of future retail contestability has been conservatively estimated by the Water Reform Program at around $320 million. That figure could rise to over $500 million if the costs of new IT systems and working capital for the four new companies are taken into account. These funds will need to be borrowed by the State on behalf of the entity and recovered from water users with a 6% increase in water charges over five years. This is in addition to the price increases already in train to pay for the water grid. We would question whether the questionable economic and efficiency benefits of the changes justify such an expense.

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Impact of the reforms on the land use planning process
In January, the QWC belatedly released a discussion paper on the options for land use planning and the establishment of the distribution entity. This crucial topic was given only a one page treatment in its May 2007 report. The QWC paper recognises that when Council water assets shift to the distribution entity, it will need to become a concurrence agency on development applications under the Integrated Planning Act, and also assume responsibility for the water and sewerage components of Priority Infrastructure Plans. This will mean that the number of development applications referred by councils for outside concurrence will rise from around 15% to around 95% (or over 9000) in SEQ, dramatically changing the development assessment process, and potentially adding significantly to holding costs for developers. The development industry, facing potential additional holding costs of $50 million a year and a highly uncertain planning and assessment environment during the transition to the new Distribution Entity by July next years, is deeply concerned about these reforms, particularly in the current uncertain economic environment.

Public Interest Map
The Weller Review proposes a Public Interest Map to help justify the creation of new entities. The Weller Review recognises the increased capacity of local government post amalgamation to deal with strategic planning and services, and recommends shifting responsibility for various smaller water boards back to local government. The report questions the continuing need for the large number of water entities in South East Queensland, arguing that water is an essential Government service. The Council of Mayors (SEQ) is of the view that shifting of water responsibilities from elected, publicly accountable local governments to appointed commercial entities would fail the threshold accountability tests of the Public Interest Map. The public sector unions have also expressed a strong view that water employees should remain in local government rather than in a commercialised entity.

Prior to the last election, the Council of Mayors (SEQ) wrote to you seeking your preparedness to reconsider the water institutional reforms in SEQ. The Government's response, signed by Treasurer Hon Andrew Fraser, gives a commitment that the Government would continue to work with SEQ councils to deliver the best water supply and customer outcomes and would 'give consideration' to our recommendations. I also met with the Deputy Premier and then Planning Minister Hon Paul Lucas on 9 March 2009, and received an assurance that the Government would discuss these matters with us fully after the election.

A reform affecting $10 billion of public assets, impacting on the jobs of 2500 council employees, adding up to $320 million to the State's debt and causing untold additional costs and uncertainties to the development industry needs to be fully justified as in the public interest. The Council of Mayors (SEQ) has always supported a regional approach to bulk water, but as the attached submission argues, we believe we can deliver a better set of outcomes for water in SEQ at the distribution and retail level without the deeply unsettling institutional reform proposed by the QWC.

/3

The better path forward for reform we propose could achieve the following outcomes:

- Economies of scale in distribution through council amalgamations and shared service agreements consistent with national and international benchmarks;
- Competition by comparison (as used with Melbourne water utilities) to encourage constant innovation and efficiency by management between council-owned water utilities;
- Agreement to improved asset management, price regulation and regional service standard regimes across the region;
- Acceleration of council efforts to streamline development assessment processes through Risk Smart, PD Online, Target 5 Days, and EDA process and standardisation of service standards;
- No disruption to land use planning and development assessment processes as these would continue to be a Council responsibility;
- No need for a $320 million loan to cover transition costs;
- No disruption to the jobs of 2500 water industry workers;
- No compromising of total water cycle management (including council responsibility for imposing water restrictions and stormwater) with councils retaining the full interaction with the community on water.

This is a better outcome for the State, Councils and, most importantly, the community. As the implementation date is just 14 months away, decisions need to be made quickly on the best way forward. Council of Mayors (SEQ) would welcome the opportunity to discuss this vitally important matter further.

Yours sincerely

Campbell Newman
CHAIRMAN

cc: Minister for Natural Resources, Mines & Energy and Trade
Minister for Infrastructure and Planning
Treasurer and Minister for Employment and Economic Development
Minister for Local Government
SEQ Mayors

Council of Mayors
South East Queensland

A BETTER, BALANCED APPROACH FOR WATER REFORM IN SEQ

In May 2007, the Queensland Water Commission (QWC) produced a policy paper *Our Water Urban Water Supply Arrangements in South East Queensland*, (hereafter QWC paper) later adopted by State Cabinet, for reform of water institutions in South East Queensland (SEQ). It proposed:

- Establishment of two major bulk water suppliers (owned by the State), a water grid manager and a bulk carrier;
- Separation of water distribution and retail functions of Council water businesses, and the establishment of a single water distribution company (sewerage works and pipes) and three retailers, to be run on commercial lines; and
- A regulated asset management and price regime for water entities.

Councils supported the establishment of the Grid Manager and bulk suppliers, but have opposed the distribution and retail arrangements, arguing they provide few benefits and add substantial costs on current integrated Council water businesses.

The recent report from a review headed by Professor Pat Weller entitled *"Brokering Balance: A Public Interest Map for Queensland Government Bodies"* (hereafter the Weller Review) sets out and applies a Public Interest Map for the establishment and retention of public bodies. The Weller Review questioned the need for the myriad new water entities in SEQ once the drought emergency had ended. It recommended that the special purpose vehicles and the four new bulk water entities be folded back into the former Department for Natural Resources and Water to improve governance and accountability. The report presents a compelling case for Government oversight of water resources, and recognises the enhanced capacity of larger post-amalgamations Local Governments to undertake strategic planning of water and other issues. Its Public Interest Map threshold tests for the establishment of public bodies, if applied to the QWC's proposal to establish four additional water distribution and retail businesses in SEQ owned by Local Government, would almost certainly recommend that these functions be retained by Local Government.

The QWC paper contained little economic, financial, legal or land use planning analysis for the rationale or of the consequences of its model for new water distribution and retail companies, a model which has never been implemented anywhere in the world. With just 15 months to go to the implementation date, many of the key strategic and policy issues still remain unresolved. This will have ramifications on the role of democratically elected Local Governments in land use planning. The livelihoods of 3,000 water employees, $10 billion of public assets, and the impact on the development industry, already rocked by the financial crisis, hang in the balance.

Further, the onset of the global economic crisis brings into question whether a reform, involving a potential cost of up to $320 million (to be funded by State borrowings) and likely to add considerable delays, uncertainties and holding costs for developers in the development assessment process, can be justified (see Appendix B for full costings).

Since 2007, there have been four major reviews of water institutions by economic regulators in NSW, Victoria, Western Australia and Tasmania (see Appendix A). All have expressly rejected the approach adopted by the QWC. The interstate reviews address some of the issues not addressed by the QWC in seeking to define the efficiencies achievable from economies of scale and scope and from vertical and horizontal integration. The analysis of international research shows little support for the basic economic arguments presented by the QWC.

Research commissioned by the interstate reviews suggests that economies of scale are achieved at around 125,000 connections, well below Brisbane (440,000) and Gold Coast (230,000) and around the size of the amalgamated regional Councils of Moreton Bay (113,000) and Sunshine Coast (107,000).

The reviews also suggest that diseconomies emerge in very large entities, suggesting Sydney Water (at 1.6 million connections) is becoming too large. The National Water Commission's urban water utilities performance report shows that the larger SEQ water entities (Brisbane and Gold Coast) have achieved economies of scale comparable to other entities interstate.

The single distribution entity and three retailers will cost between $200 million and $320 million to establish (depending on the nature of retail contestability). This will need to be borrowed (when Queensland's credit rating is already at risk) and recovered from water customers. Over a five year price path, it would result in a 6.1% increase in water charges. This would be on top of the 147% increase in prices (between 2007-12) to help fund the water grid. It would be many years before such efficiency gains could be met by the new water companies by reducing staff and other costs.

The separation between distribution and retail has been rejected by every other state in Australia and has not been implemented anywhere in the world. Other States have also accepted that water is different from electricity because more of the capital costs are tied up in the monopoly distribution role, leaving less scope for economies to be achieved in the contestable retail space. The large capital cost of establishing retailers capable of retail contestability (in excess of $200 million) cannot be justified in light of the limited efficiencies available. Other States have instead focused on improving the access regime to the distribution network as the main pro-competition reform.

Competition of a form can be achieved through 'competition by comparison'. In Melbourne, three geographically distinct integrated water distribution/retail entities are subject to comparative performance scrutiny by the public, by regulators and by Government, holding management to account. Similar dynamic efficiencies could be possible by comparing Queensland entities (e.g. Brisbane Water vs Gold Coast Water on leaks), but would be lost in a single distribution entity.

A key concern is the impact that the water reforms will have on the role of Local Government in land use planning and development assessments. With the distribution entity becoming the owner of the assets, the QWC has proposed that it become a 'concurrence agency' for development applications. Current referral to concurrence agencies typically adds 4-10 weeks to a development application assessment. With the water distribution entity becoming a concurrence agency, the number of development applications referred from Councils would rise from around 1500 a year (15%) to over 10,000 (95%). This will add considerable delays to development assessment processes and holding costs for developers, particularly in 2010-11 as the new entity gets established. This is of major concern to developers hit by economic downturn and for any Government with job creation and affordable housing as priorities.

The new water entity will also have a major impact on infrastructure planning, pricing and sequencing of water and sewerage works. The entity will be run on a fully commercial basis, subject to an asset management plan and prices agreed to by the regulators. There will be a lot less scope for Councils to influence water and sewerage infrastructure rollout, whether by discounts on charges or sequencing decisions, as these decisions will rest with the independent commercial directors of the entity.

The QWC paper proposes other reforms including regulating asset management plans, pricing, regional standards of service and an access regime. <u>These regulatory reforms can be achieved independent of the structural reforms, and without incurring up to $320 million in transition costs.</u>

This paper sets out an alternative approach, building on the learnings from the Weller Review and from the reviews by economic regulators in other States. It proposes a reform model that meets the State's regulatory reform objectives without compromising public accountability or the land use planning system or creating unnecessary costs or uncertainties in a difficult financial climate.

RESPONSE TO THE WELLER REVIEW OF STATE GOVERNMENT BODIES

The Council of Mayors (SEQ) welcomes the Weller Review as a timely reminder of the underlining principles of public administration and the importance of proper public accountability of public bodies. We particularly endorse the core premises of the Weller Review, outlined in its Public Interest Map (p.205):

"Government Ministers are responsible to Parliament, and ultimately to the electorate, for the operation of all departmental and non-departmental bodies within their portfolio. A portfolio department is the organisational form of first choice for government. Delegation, or devolution of public power should be unambiguous, transparent, granted and exercised in the public interest, accountable, and subject to review."

The Weller Review establishes a 'threshold test' for the creation of new public bodies. Having established that an activity should be done by government, it asks if there are compelling reasons why it should not be done by a department or other existing body (e.g. Local Government). The Council of Mayors (SEQ) views this threshold test as a sensible approach to justifying the creation of new bodies, and the retention of existing bodies.

Local Government is a statutory creation of the State Government, although Local Government Councillors have their own direct public accountability to the electorate that elects them. The Weller Review strongly supports the role of Local Government, proposing that responsibilities from various boards are added back to Local Government for example, River Improvement Trusts, local water boards, Mt Gravatt Showgrounds. The Weller Review notes that the Local Government amalgamation process (which reduced the number of Councils in SEQ from 18 to 11) strengthens the role and capacity of Local Government. In arguing for local water boards to be shifted back to Local Government, the Weller Review noted (p.85):

"Two significant circumstances have changed, relatively recently –

• Local Government has been amalgamated to provide, among other things, a more strategic capacity for planning.

• Water has become a strategic, rather than a local problem. Drought and shortages of water resources has led to the creation of large SPVs in South East Queensland as an emergency response."

The Weller Review stated clearly that that "Government oversight of water is essential, whether provided by a statutory authority, Local Government or other body (p.89)." This underpins its views on SEQ water entities:

"p.91 The range of water bodies that exist in south east Queensland was a response to the drought crisis. A number of statutory agencies and Special Purpose Vehicles (SPVs) were created to provide a focused, strategic approach to provide as rapid relief as possible in terms of joined-up infrastructure (pipes connecting different major sources of water), desalination plants, recycled water and water restrictions. The Auditor-General has warned elsewhere of the potential problems with SPVs. These bodies could later create issues of governance and accountability.

"...SPVs may be a good response to emergency, but demands for accountability require that, when the emergency has passed, such bodies be folded back into government management. Therefore, once the majority of these drought-proofing activities are completed, the water bodies can be consolidated. They can be functionally organised into water supply and water delivery bodies, to allow a degree of purchaser/provider split between the two. If there is to be a separate regulator, then it should be entirely distinct with no overlapping personnel.

"The Directors-General of the sponsoring departments all agree that there are too many bodies to manage water in South East Queensland, acknowledge that they were established during a critical drought period, and agree that the structure and number of these bodies could now be changed."

The Council of Mayors (SEQ) strongly supports this view. We recognised that a strategic regional approach to bulk water supply was needed during the drought crisis. We called for a small, independent Water Commission to do that role, and supported the SPVs to fast track the rollout of water infrastructure. We endorse the Weller Review's conclusion that there are now too many water entities in SEQ and too little accountability, and that it is appropriate to review the role of many of them and fold some functions back into the department.

- **Queensland Water Commission:**

Council of Mayors (SEQ) supports the abolition of the QWC, and the Weller Review's conclusion that it has largely done its job. The Department of the Environment and Resource Management (ERM) should establish a small high level Planning Advisory Committee comprising State and Local Government representatives, supported by a small secretariat and expert advice, to provide input and focus on the regional water strategy. Alternatively, this role could be performed by the current NRM CEOs Committee.

- **Queensland Bulk Water Supply Authority (trading as SEQWater); Queensland Bulk Water Transport Authority (trading as LinkWater); Queensland Manufactured Water Authority (trading as WaterSecure):SEQ Water Grid Manager:**

Council of Mayors (SEQ) supports the view that there are too many water entities in SEQ. Up to 2007, one (e.g. Gold Coast Water) or two (e.g. SEQ Water and Brisbane Water) water entities were involved in the water supply chain in each region. Now, there are five, and in 2010 there will be seven, each with its own overheads. The SEQ Grid Manager should be folded back into the Department, but may need access to some continuing commercial advice and capacity. The Bulk Water Transport Authority (LinkWater) should be merged with the Bulk Water Supply (SEQWater). The Manufactured Water Authority (WaterSecure) could also be merged with the SEQWater, as they have been in other states, although a public interest case could be made for separating rain-dependent water supplies from manufactured water. Council of Mayors (SEQ) supports the view that Government oversight of water is essential, but believes this can be done in a closely held Government authority with appropriate accountability.

The Weller Review did not consider the still unfolding half of the QWC's reform agenda of SEQ water entities[1], which involves the creation of an additional four fully commercial Local Government owned entities to manage distribution and retail, while leaving the ten[2] Local Governments in charge of water cycle management, stormwater, demand restrictions, and land use planning. Council of Mayors (SEQ) submits that application of the Weller Public Interest Map to the business case for the four new SEQ water entities would show that a strong case has not been made for their establishment. The following table applies the Public Interest Map to the four new SEQ water bodies:

[1] QWC "Our Water: Urban Water Supply Arrangements in South East Queensland" May 2007
[2] While Toowoomba Regional Council is a member of the Council of Mayors (SEQ) it is currently excluded from the institutional water reforms.

Does the activity need to be done?	Yes. Governments certainly need to control the supply and delivery of water, either directly or through authorities. (p.86)
Should the public sector undertake the proposed activity?	Government oversight of water is essential, whether provided by a statutory authority, Local Government or other body (p.89).
Is there a compelling reason why a department cannot, or should not undertake the proposed activity?	
- organisational capacity	No. Amalgamations have enhanced the organisational and strategic capacity of Local Government (p. 85).
- independence	No. Commerciality, or even privatisation, may be appropriate forms of response, but it should not be the primary test of public interest. Too often it is presented as a means of bypassing accountability and due process for the expenditure of what remains public monies. (p. 92)
- public interest risk	No. The risk is the other way, as it would involve substantial delegations of development planning and assessment functions from elected Local Governments to a commercial entity.
- essential public participation and consultation	No. The public has more access to decision making through elected local Councillors than to an appointed, commercial board.
What form should it take?	SPVs may be a good response to emergency, but demands for accountability require that, when the emergency has passed, such bodies be folded back into Government management. (p. 91)
How should it govern and be governed?	The Auditor-General of Queensland has confirmed that companies in the public sector present 'an area of governance weakness in the overall accountability framework as it currently exists in Queensland'. (p.42) Government agencies are the more appropriate form for water entities (p. 91).

Recommendations:

- **That the State Government adopt the Public Interest Map in the assessment of current and future water institutions in SEQ.**
- **The Queensland Water Commission be abolished and its functions transferred to the Department of Environment & Resource Management (DERM).**
- **That the Water Grid Manager be transferred to the Department.**
- **The Bulk Water Supply Authority, the Bulk Water Transport Authority and Manufactured Water Supply Authority be closely held government authorities, preferably merged (as in NSW and Victoria) or with Manufactured Water separated if justified in the public interest.**
- **The proposal to establish four Local Government owned corporations to manage water distribution and retail clearly fails the Public Interest Map, and these functions remain embedded in Local Government.**

The remainder of this paper expands on the public interest case for a better model than setting up four new water distribution and retail entities in SEQ.

A BETTER BALANCE FOR WATER REFORM IN SEQ:

Objectives:

- **Achieve economies of scale and scope in water businesses;**
- **Develop an economic regulatory oversight and asset management regime that delivers more accountability for prices and performance for Council owned water businesses;**
- **Ensure Councils retain their primary role in land use planning with minimum disruption to development application process.**

1. Achieve economies of scale and scope in water businesses:

The objective of the QWC paper is to deliver '*over time, significantly improved services to consumers arising from improved asset management and specialist entities with a clear focus on service delivery.*' It proposes doing this through abolishing vertical integration and imposing horizontal integration of water businesses. Each layer of water business activity from retailing, through distribution, through transport to bulk would be separated. Horizontal integration would be imposed with single entities doing bulk water and distribution, and with the number of 'retailers' reduced from 17 Councils to 3 retailers. The 10 Councils would continue to have a role in managing stormwater, total water cycle management, land use planning and water restrictions. On the Gold and Sunshine Coasts, the number of bodies involved in the delivery and management of water will rise from one (the Council) to seven, and from two (Council and SEQ Water) in Brisbane to seven, creating the most complicated water system in Australia.

Councils have always supported the establishment of a single entity to manage bulk water, but have long opposed reforms proposed at the distribution and retail levels. The QWC 2007 paper contains no economic data to support its assertion that grouping of assets will achieve economies of scale, or that its institutional reforms are necessary to deliver strengthened asset management arrangements and transparent budgeting.

This is a massive flaw in the water reform process, as the reform process envisaged by the QWC is enormously costly and disruptive, with an implementation price tag of up to $320 million to get the new entities established by July 1 2010.

By contrast, several major reviews of water entity arrangements in NSW by Independent Pricing and Remuneration Tribunal (IPART2005, 2007), the Victorian Competition and Efficiency Commission (VCEC 2008) and the Western Australian Economic Regulation Authority (ERA 2008) have considered the questions of economies of scale and scope and come to vastly different conclusions to the QWC's report. Some of the key findings of the various reviews include:

<u>1a. On economies of scale</u>

- Economies of scale in water supply is a combined measure that reflects economies of volume, customer numbers and service area size. There appear to be substantial economies of scale with respect to volume delivered, but this effect is counteracted by increasing numbers of customers and service area size (WA ERA 2008).

- The minimum efficient scale for water businesses is estimated by different studies to lie within a wide range – between 125,000 and one million connections. Some studies suggest economies of scale dissipate beyond around 400,000 connections, and there appears to be diseconomies of scale for large firms. The minimum efficient scale for wastewater is around 100,000 connections (WA ERA 2008 based on an ACIL Tasman Report).
- Sydney Water - in servicing 1.6 million connections - 'is at or approaching a size at which utilities in other jurisdictions have been found to experience diseconomies of scale.' It said that the minimum number of connections is 'much lower than 1.6 million' for economies of scale (IPART 2005).
- VCEC concludes that Melbourne's three retailers are operating at an efficient scale, and consolidation from three retailers to one can at best have only a relatively small impact on retail water costs and prices, and non-structural options should be considered (VCEC 2008).

In summary, the detailed analysis by the three economic regulators in the other states have concluded that the minimum economy of scale is around 125,000 connections, plateauing through to a point (approaching 2 million connections) where diseconomies of scale set in. In fact, IPART canvassed the need to horizontally split Sydney Water into two entities to avoid diseconomies of scale, although recommended not to do so 'at this stage'.

Within SEQ, the two largest water businesses are Brisbane (440,000 connections) and Gold Coast Water (230,000 connections), both well above the minimum level of connections for economies of scale (125,000 connections). The newly amalgamated Moreton Bay and Sunshine Coast Regional Councils are at the threshold of the network size for economies of scale. The combined distribution entity would have around 1.1 million connections, making it larger than any of the Melbourne water businesses and second only to Sydney Water. By 2026, based on medium population forecasts, SEQ will be at 1.6 million connections, and fast approaching the same diseconomies of scale IPART has identified in Sydney.

Queensland Water Entities – No of connections:

Council	**2005/6**	**2016***	**2026***
Brisbane	428,000	493,000	522,000
Gold Coast	216,000#	285,000	342,000
Moreton Bay	123,000	156,000	184,000
Sunshine Coast	114,000	147,000	178,000
Logan	80,000#	97,000	119,000
Redland	60,000	72,000	83,000
Ipswich	54,000	82,000	133,000
Scenic Rim	7,000#	9,000	12,000
Lockyer	12,000	16,000	20,000
Somerset	4,000	5,000	6,000
Total	**1,086,000**	**1,362,000**	**1,599,000**

*Based on PIFU population projections medium series; #estimate based on new boundaries

The National Water Commission reports annually on the performance of urban water utilities. Its data support the broad proposition that economies of scale and lower operating costs are achieved in large entities above 100,000 connections. But, its data also supports the broad proposition that above that range, there is no significant improvement from further economies of scale. Rather, it is a function of management performance, efficiency and regulation.

NWC Performance indicators 2007-8:

	Large utilities (>100,000)	Medium (50-100,000)	Small (20-50,000)	Very Small (10-20,000)
Water loss (l/connection/day)	68L/c/d	75L/c/d	81L/c/d	110L/c/d
Water main breaks (per 100km)	32	23	20	15
Sewer main breaks (per 100km)	49	31	42	49
Operating cost (per w & s connection)	$481 ($361– 609)	$595 ($355-768)	$726 ($285-1629)	$731 ($486-1110)
NPAT (% revenue)	16%	6%	5%	11%

NWC Performance indicators 2007-8 – Large utilities:

	No of connect-ions.	Water loss (l/conn / day)	Water main breaks (per 100km)	Sewer breaks per 100km	Operating cost (per property)	NPAT (% revenue)	Rate of Return
Sydney Water	1.74m	91	30.0	64.0	$589	11%	0.7%
WC - Perth	0.69m	86.0	14.0	20.9	$391	57%	4.9%
Yarra Valley	0.66m	75.0	49.0	46.3	$421	2%	2.4%
South East (Melb)	0.63m	57.0	21.0	20.7	$396	10%	3.1%
SA Water	0.51m	63.0	25.0	58.2	$361	23%	5.7%
Brisbane Water	0.44m	75.0	31,1	27.6	$529	8%	6.2%
City West (Melb)	0.34m	59.0	68.0	28.6	$515	9%	6.2%
Gold Coast Water	0.23m	58.0	18.0	17.6	$530	n.a.	3.7%
Hunter Water	0.22m	80	30.3	50.2	$431	18%	2.2%

SEQ Council owned water businesses operate with lower levels of community service obligation subsidies than interstate: Brisbane Water – 1% of revenue; compared to Sydney Water's 5% and Melbourne's 6-7%. [3] The NWC also noted the dramatic improvement in asset performance in SEQ, with Brisbane Water's real losses falling from 141 litres/connection/day in 2005-6 to 75 l/c/d 2007/8, and Gold Coast Water recording one of the best outcomes in Australia.

It should be noted that other factors can impact on the cost of water. Due to its geographic features, Redland for example has been able to supply water more cost effectively than many larger Councils. Other small Councils have entered into arrangements to share and hence, reduce costs. The three western Councils, for example, were partners in the Esk Gatton Laidley Water Board which jointly owned and ran the water treatment plant for the Lockyer Valley. As a closely controlled entity, operational costs were pooled but control over planning decisions remained with the Council. Councils have long had service agreements with each other, such as the agreement between Logan, Scenic Rim and Gold Coast sharing various pieces of infrastructure.

[3] NWC National Urban Utilities Performance Report 2007-8 p. 83

With the amalgamation, there is scope for considerable upsizing of council water operations, with the number of water retailers in the region having been reduced already from 17 to 10. Introducing the reforms, the then Local Government Minister said amalgamations were *"all about building stronger Councils for a growing Queensland."* With amalgamation, the four largest councils covering 77% of the population of SEQ will be of sufficient size to meet the 125,000 connections benchmark for economies of scale in water utilities. Further, amalgamations will also dramatically increase scale in other councils (e.g Lockyer, Somerset, Logan and Scenic Rim).

Recommendation:

- **There is no evidence that further economies of scale can be achieved by increasing entities the size of Brisbane Water or Gold Coast Water, although economies of scale might be achievable from scaling up of smaller entities (<125,000 connections).**

1b. On Economies of Scope and vertical integration

The QWC recommends the separation of retail from distribution, and consideration of possible future retail contestability. The argument is based in part on similar reforms achieved in other utilities such as electricity (p.36). The Victorian and Western Australian reviews considered the approach advocated by the QWC and expressly rejected it. The VCEC (2008) warned that:

"Separation of distribution and retail has not been implemented anywhere in the world, and more data on potential benefits and costs would be helpful."

It warned change would involve substantial transaction costs for questionable gain. For example, the separation of distribution and retail within Energex cost more than $72 million, a cost Energex has sought to recover from consumers. Preliminary estimates suggest that capital of setting up retailers capable of full retail contestability (as recommended by the QWC) is in excess of $200 million.

In NSW, IPART's 2007 review, drawing on work by Tasman Asia Pacific, noted that vertical separation is less relevant to water compared with electricity and gas as the monopoly part of the industry (transport) is a higher proportion of both assets and costs, leaving less room for cost savings on retail aspects:

	Transportation Infrastructure as a % of assets	Transportation costs as a % of total costs	Production costs as a % of industry costs
Water	70	21	31
Electricity	50	8	50
Gas	60	14	40

All three interstate reviews rejected separation of retail from distribution (but Victoria suggested accounting ring fencing to improve transparency of costs).

Recommendation:

- **Retail and distribution be kept within single entities, with consideration given to accounting ring-fencing for transparency purposes.**

1c. On horizontal integration

The QWC argued that distribution is a monopoly activity and should be in a single regulated entity. Yet, this falls short of regulatory best practice which has been evidenced in Victoria, where 'competition by comparison' or 'yardstick competition' has been put in place between the three **geographically distinct metropolitan entities.** The VCEC discusses the 'competition by comparison' model used between the three Melbourne water entities and concludes that the Victorian entities are performing at a level at least comparable to, and more likely, above that of other Australian water businesses and appear comparable with overseas entities. The WA ERA (2008) noted the Victorian experience and that the horizontal separation of network/retail businesses may lead to increased dynamic efficiency through competition between similar businesses, that could offset some or all of the economies of scale. It recommended against a 'north/south' separation of the Water Corporation because there was already effectively an operational separation and an adequate competitive tendering and regulatory oversight process in place.

IPART (2005) noted that horizontal disaggregation of Sydney Water 'could allow for 'comparative or yardstick competition; between two or more water utilities, which can help regulators and consumers assess performance and put pressure on managers, but that care has to be taken that the entities are truly comparable. It stated it 'believes that disaggregating Sydney Water horizontally has the potential to provide opportunities for productive efficiency gains, but that it was not yet confident that benefits would outweigh the costs.

There is strong evidence that yardstick competition between the three Victorian water entities has led to dynamic efficiencies being achieved between the entities and a strong managerial focus on efficiency improvement, enforced by performance reporting to the public and the regulator. Such an approach can encourage and reward innovation.

Recommendation:

- **That competition by comparison can deliver significant dynamic efficiencies in comparing 'like with like' between geographically distinct distribution monopoly water entities.**

2. **Develop an economic regulatory oversight and asset management regime that delivers more accountability for prices and performance for Council owned water businesses;**

The regulation of water prices in Queensland is light-handed compared with other states. As water is an effective public monopoly, the QWC's proposals for more robust economic regulation of prices and for more rigorous asset management planning is consistent with approaches in other states. However, the benefits that can be delivered through such a process can just as easily be done through several Council owned entities as through one. The structural reforms are totally separate and distinct from the regulatory reforms. The structural reforms should be considered on the broader policy questions of economic efficiency and land use planning. The regulatory issues are an agenda in themselves.

To assist the establishment of a more effective regulatory regime, each Council structurally separates its water business within Council, which is of course currently happening. Water prices need to be justified to the Queensland Competition Authority (QCA), with a strong emphasis on improving efficiency over time (e.g. meeting efficiency performance targets). Competition by comparison would significantly assist in this process while recognising and rewarding innovative approaches.

The regulators should have a brief to pursue region wide efficiencies where these are justified. Some examples of such efficiencies might include:

- Technical cooperation on water distribution between Councils, with jointly developing region wide capital investment plans (particularly for new greenfield developments) and cross border arrangements to achieve technical cooperation and efficient investments, and a reporting mechanism under regional water arrangements;

- Common service provision where efficiencies can be identified (e.g. back office billing systems etc.);

- Bulk procurement of materials, supported by moving to common service standards;

- Open book benchmarking; and

- Pursuit of total water cycle management objectives.

Councils could agree to an 'efficiency audit' of the system to identify areas of technical inefficiency that could be addressed through better engineering or regional rationalisation of infrastructure.

Recommendation:

- **That the Council owned water businesses be subject to price regulation and an improved asset management regime broadly in line with that proposed by the QWC.**

3. Ensure Councils retain primary role in land use planning with minimum disruption to development application process.

The QWC paper comprehensively failed to properly address the impact of its water reform proposals on land use planning and the development approval process. Key concerns of Councils with the proposal are:

- The role of democratically elected Local Governments and the State in land use planning will be reduced with water and sewerage issues subject to concurrence (and effective veto) by a water business run on commercial lines of corporate responsibility;

- Delivery of key infrastructure services to support growth will now be a decision of an unelected water entity rather than Local Government;

- Future infrastructure charging and planning will (at least for the 3-4 year transition period) be much more uncertain. Development costs are likely to rise as the distribution entity will be operating on transparent cost recovery principles, and the capacity of Councils to subsidise development costs to serve broader community objectives lessened;

- The capacity of the distribution entity to debt-finance future development could be impacted by the GFC and the State's borrowing capacity;

- While Councils are likely to remain the 'development application managers', development application processes are likely to be longer and more complicated with the number of applications needing to be referred to a concurrence agency rising from a few hundred to potentially 10,000 a year;

- There will be a lack of clear accountabilities for land use planning and development application, with no clear cut arbiter (currently such disputes are resolved within Councils);

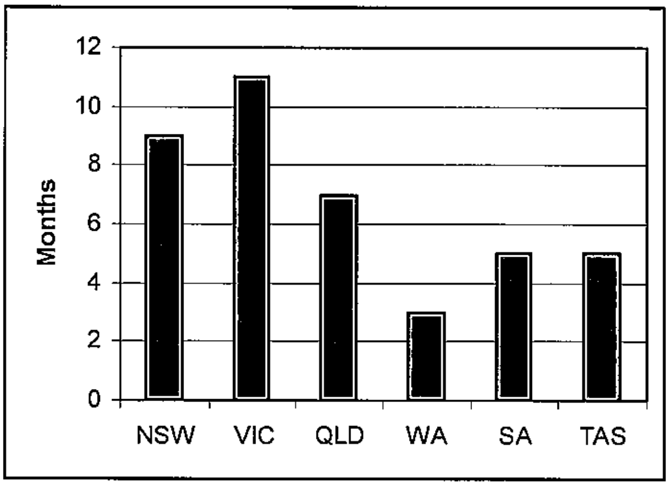
- External applicants will face the additional cost of separate, time consuming negotiations (and fees) with the distribution entity as well as those with Council. The Distribution Entity will not have a clear investment strategy in place by 2010, adding to uncertainty.

- Planning and management of stormwater is separated from broader water and wastewater, making it more difficult to achieve total water cycle management objectives.

The fundamental question is that once ownership of the asset shifts from Council to a separate commercial entity, the new entity must have control over its own capital investment planning. At that point, Councils cease to be a 'one stop shop' in terms of land use and infrastructure planning and development assessments. Either a cumbersome concurrence agency referral process is established, or the Integrated Planning Act needs to be radically restructured to take out water (as occurs with electricity and already occurs in Sydney), thereby defeating the objectives of integrated planning and, more importantly, total water cycle planning.

A 2003 survey of architects found that delays in planning assessments (including pre-lodgement activities) where shorter in Queensland (where Councils have a greater planning role) than in NSW or Victoria. The 2008 Planning Report Card for the Planning Institute of Australia ranked Queensland's planning system and performance higher than all other states in managing growth, in terms of governance structures and planning for infrastructure, and placed Queensland ahead of Victoria and Western Australia and on par with New South Wales on streamlined assessment processes.

Architects' assessment of planning approval delays (medium density housing) 2003



RAIA Planning Assessment Survey Report 2003

Delays in development applications cost money, and in the current economic environment, could have an adverse impact on planning outcomes. SEQ Councils currently process approx 10,000 Development Applications (DA's) a year. Around 16% of these DA's are referred to State agencies for concurrence, adding an average of around 7.5 weeks to decision making. A 2007 LGAQ survey found 13% of DA's referred to State agencies were not responded to within statutory timelines. Of the 13% of DA referrals that did not comply, there were 5 involving EPA (average 15 weeks), 11 involving DNR (average 5.6 weeks), and 18 involving MRD (average 11 weeks) (Q.11). The LGAQ estimates the holding costs on DA's are around $500 per dwelling per week. The addition of a water and sewerage referral agency could cost the development industry as much as $50 million in holding costs if the DE turns applications around in the 7.5 week average of other concurrence agencies.

If the water businesses remained within Council ownership (even in separated businesses), many of these problems would be avoided. Councils, as the owners of the assets, would continue to be responsible for water infrastructure planning and charging and development assessments. Councils could continue to cross subsidise and optimise water and sewerage infrastructure to support whole of community outcomes.

For the development industry dealing with the economic downturn, such an approach:

- Avoids large upfront transitional costs and ongoing extra land planning costs;
- Delivers most QWC objectives without the confusion, costs and uncertainties for developers and Councils in the three to four year transition period;
- Will not add time and complexity to DA process with greater opportunity for improvements to DA processes by having Councils managing DA process.

As part of an ongoing performance improvement programs, Councils could:

- develop a regionally consistent set of development standards for water and sewerage;
- continue to accelerate improvements in DA processes (e.g. Smart EDA, Target 5 Days etc., accelerating Priority Infrastructure Plans), possibly using some of the 'savings' from not implementing the reform process;
- move towards third party certification of operational works (technical design).

Where two or more Councils combine their water businesses to achieve economies of scale, the nature of ownership could be so closely held (e.g. though joint ventures or possibly through shared service delivery functions) that the asset planning and approvals would still remain with Council. Importantly, this also provides a better framework for delivery of integrated water cycle management and water quality outcomes, and for active demand management.

Recommendations:

- **That integrated water businesses continue to be owned directly by Councils (possibly through joint ventures between smaller Councils), with Councils responsible for infrastructure planning (subject to approval of an asset management plan by the economic regulator), land use planning and development assessments.**

- **That Councils engage in joint region wide activities to develop region wide standards of service on operational works and water infrastructure, and on further streamlining the development assessment process.**

APPENDIX A:

MAJOR REVIEWS SINCE THE QUEENSLAND WATER COMMISSION'S DISCUSSION PAPER ON SEQ WATER INSTITUTIONAL REFORM (MAY 2007)

Victoria: ***Inquiry into Reform of the Metropolitan Retail Water Sector (Victorian Competition & Efficiency Commission) February 2008***

- Structural reform will not deliver the significant cost and price reductions Government sought.
- Consolidation from three retailers to one can at best have only a relatively small impact on retail water costs and prices, and non-structural options should be considered.
- Savings of $8 to $10m per annum should be achievable from shared services, bulk procurement of materials and open book benchmarking.
- Separation of distribution and retail has not been implemented anywhere in the world, and more data on potential benefits and costs would be helpful. To this end, the Commission has recommended implementing accounting ring fencing of the retail and distribution functions.
- The Government should establish an access regime for water and wastewater infrastructure services.

The VCEC discusses the 'competition by comparison' model used between the three Melbourne water entities and concludes that the Victorian entities are performing at a level at least comparable to, and more likely above that of, other Australian water businesses and appear comparable with overseas entities.

The Commission looks at the evidence of economies of scale in the water industry, drawing heavily on the 2007 WA ACIL Tasman report and the 2007 IPART report. It notes several studies have found diseconomies of scale for very large water businesses (more than 2 million connections), and that several studies have found economies of scale from integrating water wholesale with distribution and retail functions. Based on the above, the VCEC concludes that the literature does not support that Melbourne's retailers are operating at an inefficient scale.

On vertical separation of retail and distribution, the VCEC's draft report said (p 83):
"This option is technically more challenging to implement than retail consolidation. And, as noted, the Commission is not aware that such a structure has been employed anywhere in the world. There is also very little technical literature on how such an option would work in practice"

NSW: ***IPART review of metropolitan water industries (September 2007)***

IPART conducted a major review of competition in the Sydney metropolitan water market in 2005, recommending a formal access regime, expressing some sympathy with 'horizontal disaggregation' (ie. splitting Sydney Water into two or more regional entities), but opposing vertical disaggregation. In 2007, it released a Literature Review on the underlying costs and structure of metropolitan water industries.

Some of the key findings of the review include:

- Vertical separation is less relevant to water compared to electricity and gas as the monopoly part of the industry (transport) is a higher proportion of both assets and costs, leaving less room for cost savings. Tasman Asia Pacific (1997) contrast the significance of water/wastewater transportation costs relative to other industries such as electricity and gas as follows:

	Transportation Infrastructure as a % of assets	Transportation costs as a % of total costs	Production costs as a % of industry costs
Water	70	21	31
Electricity	50	8	50
Gas	60	14	40

- Discussing IPART's earlier findings on economies and diseconomies of scale, the report warned that it is important to distinguish between different types of economies of scale. Short term economies of scale can be achieved through increased volumes connected to a network, but long term economics of scale where the network size is not fixed could be of more relevance. Organisational management can also cause diseconomies.

IPART's 2005 Review of Water Services recommended against major industry restructuring 'at this time', instead suggesting the focus needed to be on supply augmentation, competitive procurement of supply and improving the access regime for potential new suppliers. The review did leave the issue open for the future:

- It stated "that disaggregating Sydney Water horizontally has the potential to provide opportunities for productive efficiency gains", but that it was not yet confident that benefits would outweigh the costs.
- While there are economies of scale in water businesses, there are also diseconomies of scale at large sizes. The Tribunal concluded that Sydney Water in servicing 1.6 million connections 'is at or approaching a size at which utilities in other jurisdictions have been found to experience diseconomies of scale.'
- The Tribunal found that the minimum number asserted by the sources is much lower than 1.6 million for economies of scale, but the studies did not produce an 'optimal' size as operational characteristics differ between entities.
- Horizontal disaggregation could allow for; comparative or yardstick competition; between two or more water utilities, which can help regulators and consumers assess performance and put pressure on managers. But, care has to be taken that the entities are truly comparable.

Western Australia: ***Inquiry on Competition in the Water Sector 2007-8***

The Economic Regulation Authority held an inquiry into competition in the Water and Wastewater Services, with a final report in June 2008. It recommended:

- An Independent Procurement Entity to handle all supply source and demand management options;
- A simple third party access regime be established;
- Water trading be established as a matter of urgency;

- Full retail contestability not be established but may develop on a 'case by case basis' from the access regime.

An ACIL Tasman report on economies of scale commissioned by the Economic Regulatory Authority found:

- Economies of scale in water supply is a combined measure that reflects economies of volume, customer numbers and service area size. There appear to be substantial economies of scale with respect to volume delivered, but this effect is counteracted by increasing numbers of customers and service area size.
- The minimum efficient scale for water businesses has been estimated by different studies to lie within a wide range – between 125,000 and one million connections. Some studies suggest economies of scale dissipate beyond around 400,000 connections. (Perth has 600,000 connections).
- Meta analysis of the empirical studies suggest that economies of scale are largely exhausted beyond 200ML/day (or 73,000 ML pa). (Perth delivers over 200,000 ML p.a.)
- There appears to be diseconomies of scale for large and medium large firms. However analysis of a Saal and Parker study suggests that the Corporation is below the size where diseconomies apply.
- The minimum efficient scale for wastewater appears to be approximately 100,000.
- There appears to be little benefit from combining water with wastewater operations although potential synergies may increase with the emergence of wastewater recycling opportunities. Conversely, there appears tot be little lost from combined water and wastewater operations.
- The horizontal separation of network/retail businesses may lead to increased dynamic efficiency through competition between similar businesses, that could offset some or all of the economies of scale. This is based on an analysis of the market structure in Melbourne where it is claimed that competition between network/retail businesses has led to increased dynamic efficiencies.
- There appears to be economies in billing in terms of the provision of billing services over large customer bases and across services. However, retailing services are not considered a natural monopoly service as it is possible to profitably duplicate the services.[4]

Based on this analysis, the Authority concluded that the Water Corporations' operations in Perth exceed the minimum efficient scale, implying that there is potential for smaller organisations without any substantial reduction in economies of scale and/or scope. The Authority recommended against disaggregation of the Water Corp. into north and south regions 'at this time' because it was unlikely to yield significant benefits due to an operational level split already in operation, the high use of competitive tendering and the continuing oversight of costs by the ERA.

The Authority recommended against retail contestability for small customers due to the lack of a detailed cost-benefit analysis, the likely magnitude of

[4] ERA "Inquiry on Competition in the Water and wastewater Services Sector" Draft report Dec 2007 p. 69-70

expenditure necessary in establishing a contestable market; and uncertainty about likely entrants and demand. It said:

"On balance, while there are arguments for the separation of the bulk water functions from the remainder of the procurement, planning, distribution and retail functions, there are a range of reasons which suggest separation is inappropriate. These include the finding of the ACIL Tasman literature which indicated the existence of economies from vertical integration." [5] (p. 36)

Tasmania: ***Ministerial Water and Sewerage Reform Taskforce (Feb 2008)***

A high level Ministerial Taskforce chaired by the Treasurer reported in February 2008 recommending major changes of the Tasmanian water sector. Like Queensland, Tasmania's 29 Local Councils were the primary owners and operators of business, but underinvestment, underperformance and rising future liabilities of upgrades were key issues. The Government eventually reached agreement with the Local Government Association on a reform agenda which established three vertically integrated water providers (bulk, distribution, retail) owned by Local Government, but subject to asset management and price regulation by the State. Announcing the agreement with Local Government on 4 February 2008, Premier Paul Lennon described it as a 'watershed agreement...that strengthens the relationship between Local Government and the State Government'. Local Government Association of Tasmania president Mike Gaffney said it was "an important reform that will have long term consequences for all Tasmanians. The reform is far reaching and allows Local Government to continue to service the local communities it represents."

The review considered and expressly rejected the reform model promoted by the QWC in SEQ.

Productivity Commission - ***Towards Urban Water Reform: A Discussion Paper – March 2008.***

A high level paper discussing broader application of microeconomic reform to water industries, the Commission conceded that water industries were in many respects different from other industries, but could still benefit from application of competition principles. The Commission did, however, concede:

"Given the limited experience with variations from the centralised urban water model in Australia and internationally, it is difficult to envisage anything other than an iterative approach. Abrupt or large scale changes could generate excessive transitions, implementation and adjustment costs." (p.29)

National Water Commission – *Urban Water Utilities Performance Report:*:

The NWC reports annually on the performance of urban water utilities. Its data supports the broad proposition that economies of scale are achieved in large entities above 100,000 connections. But, its data (see p.9 on this report) also supports the broad proposition that above that range, there is no significant improvement in performance based on economy of scale. Rather, it becomes a matter of management performance, efficiency and regulation.

[5] ERA 2007 p.36

APPENDIX B:

INDICATIVE WATER REFORM BUDGET TO ESTABLISH WATER SEQ WATER DISTRIBUTION AND RETAIL ENTITIES

The table below outlines the cost categories and budgets, including a budget range for the establishment of the four entities, depending on policy settings.

Category	Budget Estimate
	$'000's
Water Reform Program (COMSEQ)	$17,000 [1]
Due Diligence	$17,000 [2]
Distribution Entity Establishment	$ 38,000 [3]
Retail General	$6,650 [4]
Council Transaction Costs	$35,000 [5]
Interest on QTC Loan for Program, Due Diligence, Retail General & Council Transaction Costs	$3,300 [6]
Sub Total (Costs before any individual retailer establishment costs)	**$116,950**
Retail Options	
Option 1: Stand Alone Establishment (non FRC) $24.5M per retailer and Distribution Entity $10M	$83,500 [7]
Total Based on Option 1	**$200,450**
Option 2: Business Model with 2 retailers sharing initially, minimum requirements Distribution Entity and (non FRC) $14.5M x 1; $18.5M x 2 & $10M DE	$61,500 [8]
Total Based on Option 2	**$178,450**
Option 3: Full Retail Contestability Model in retail $41.5M x 3; DE = $78M	$202,500 [9]
Total Based on Option 3	**$319,450**

Notes to Table Above

1. *Water Reform Program* budget estimate for total costs from commencement to completion of program in July 2010
2. *Due Diligence budget* estimate has been subject to market testing and tender
3. *Distribution Entity Establishment* budget is basic setup costs and does not include any estimate for new systems costs e.g. ERP or similar which may cost in the order of $100M
4. *Retail General* budget estimate is general consultancy to cover three retailers initial setup, and does not include initial working capital, which may cost up to $120M.
5. *Council transaction costs* are indicative only and subject to thorough documentation by Councils. These costs cover additional expenses incurred in responding to current stage of reforms. This estimate does not cover any legacy costs within Councils.
6. Interest expense is based on indicative borrowing rates for funding reform and will be increased subject to retail model. For example, if Option 2 is selected interest cost would be $6,014M based on current rates advised by QTC.
7. Option 1 is based on each retailer implementing a stand alone business model and is based on benchmarking data available for implementations in similar jurisdiction. This option does not include any costs for future full retail contestability.
8. Option 2 is based on 2 retailers adopting a shared business model, one retailer stand alone and the minimum requirements for the Distribution Entity. This option does not include any costs for future full retail contestability.
9. Option 3 is based on 3 retailers adopting stand alone business models and allows for costs associated with full retail contestability. The estimate for the Distribution Entity is based on implementation in similar jurisdictions (e.g. Energex).