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**PRODUCTIVITY COMMISSION**

**INQUIRY INTO AUSTRALIA'S URBAN WATER SECTOR**

**DR W. CRAIK, Commissioner**

**TRANSCRIPT OF PROCEEDINGS**

**AT MELBOURNE ON TUESDAY, 30 NOVEMBER 2010, AT 9.29 AM**

**Continued from 29/11/10 in Canberra**

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**DR CRAIK:** Welcome to the public hearings for the Productivity Commission into Australia's urban water sector following the release of the issues paper on 27 September. My name is Wendy Craik and I am the presiding commissioner on this inquiry. The other commissioner on this inquiry is Associate Commissioner Warren Mundy, however unfortunately he's unable to be with us today. The purpose of this round of hearings is to get comment and feedback on the issues paper and facilitate public participation in the inquiry process more generally. Prior to these hearings in Melbourne, we have met with interested parties and individuals throughout Australia. During October we held roundtables in Perth, Sydney and Melbourne.

Our public hearings opened in Sydney on 9 November, followed by Canberra yesterday and following today's proceedings hearings will also be held in Adelaide, Perth and Hobart. We will then be working towards completing a draft report for publication sometime in March 2011, having considered all of the evidence presented at the hearings and in submissions, as well as other informal discussions. Upon release of the draft report, there will be a further round of public hearings and submissions and a final report is due to the government in July 2011.

We like to conduct all hearings in a reasonably informal manner, but I remind participants that a full transcript is being taken and, for this reason, comments from the floor cannot be taken, but at the end of today's proceedings, I will provide an opportunity for any persons wishing to do so to make a brief presentation. Participants are not required to take an oath, but should be truthful in their remarks. Participants are welcome to comment on the issues raised in other submissions. The transcript will be made available to participants and will be available from the commission's web site following the hearings. Submissions are also available on the web site.

To comply with the requirements of the Commonwealth occupational health and safety legislation, you are advised that in the unlikely event of an emergency requiring evacuation of this building, you should follow the green exit signs to the nearest stairwell. Lifts are not to be used. Please follow the instructions of the floor wardens at all times. I would like now to welcome our first participants, Greg Hoffman and Simone Talbot, appearing for the Local Government Association of Queensland. Could I ask you both to introduce yourselves, giving your name and organisation for the record and then, Greg, if you would like to make a brief presentation or some brief opening remarks, I'd be happy to hear them.

**MR HOFFMAN (LGAQ):** Thank you, commissioner. Greg Hoffman is my name. I am the general manager of advocacy for the Local Government Association of Queensland.

**MS TALBOT (LGAQ):** Simone Talbot. I am the manager of advocacy, roads,

transport and economics for the Local Government Association of Queensland.

**MR HOFFMAN (LGAQ):** The association welcomes the opportunity to make this submission. The issue of urban water supply in Queensland, as it is nationally, is a significant issue of debate, of significant contention as to where it's at and where it should go and the terms and conditions on which it should operate into the future. By way of background, I'd like to provide you with some scope and scale of the operations of local government and local government water, the water sector in our state. There are 73 local government councils, 45 non-indigenous and 18 in our indigenous communities across the state.

That was 157 councils until amalgamation processes occurred in 2008. In addition to that, there are five state entities involved in bulk water supply. Four of those operate in South East Queensland and have recently been established as part of the water reforms in that region. One is a statewide bulk water supplier operating major dams and facilities across the state, predominantly for agricultural or irrigational water supplies, but obviously supplementing urban supplies. There are two state water boards operating at Mount Isa and Gladstone.

Out of the reforms of South East Queensland, there are three local government owned distribution and retail companies. There is one existing local government corporatised water entity in the Wide Bay Burnett region. There are 32 private sector companies involved in water supply, predominantly for commercial and industrial purposes, such as mining and resources-related activity, as well as resort islands. There are two state government departments and in total there are 340 water supply schemes and 180 waste water schemes.

Those numbers might suggest that the sector is ripe for further reform in our state. We in local government do not deny that opportunities should be explored into the most appropriate ways in which the water sector can operate and in our submission we've identified where and how that is taking place. I'll comment on that a little further in a moment. But to make the point about the characteristic about the settlement patterns in Queensland, I'd like to table a map here which does show where and how that dispersal of the state's population, its decentralisation in terms of urban water supply and other related industry, creates in some respects the circumstances that I've just outlined and is very relevant to any consideration of reforms that might take place. So if I can present that for our consideration.

**DR CRAIK:** Thanks, Greg.

**MR HOFFMAN (LGAQ):** As you are aware, significant reform has taken place in the urban water supply arrangements in South East Queensland. It is still a work in progress and judgments will be made, as they are being made at the moment, but will be more informed in due course as to the appropriateness of those reforms and

whether they still need to be further refined. There is a public debate as to what further changes it might take to in fact improve the situation where, as I indicated before, we have four state entities involved in bulk water supply and three local governments involved in distribution and retail across nine local government areas in the south-east corner.

The rest of Queensland is likewise subject to investigation as to what might occur to improve the water supply arrangements outside of South East Queensland. The approach being taken to this by the state government is quite different to the approach taken in relation to South East Queensland where the government unilaterally decreed what that reform would be and proceeded in what was quite an adversarial approach to the final determination and implementation of those reforms. That environment still exists, regrettably, because it is, if you like, clouding the consideration of the more significant and relevant strategic and long-term issues relevant to water supply.

The approach outside of South East Queensland is quite different. It is being approached in a collaborative manner by state government, working closely with the local government sector through ourselves, as the association, and the water industry generally. The government has quite openly said it doesn't have an appetite for the nature or the approach to reforming the water sector outside of South East Queensland in the way it did in that location. It's lost its appetite for that change and some would suggest it might lose more than its appetite as a consequence.

The issues for us centre around diversity and the dispersal of the water supply systems and arrangements across the state, as reflected in the map I've just tabled. Our submission identifies that we are open to change and that the commission, in considering what are the important elements to progress or to promote or to recommend to governments at all levels, should recognise that the one size fits all model doesn't apply, that a collaborative approach is fundamental and that to the greatest extent possible, responsibility for the provision of essential services and in this case water, should lie with the institutions at the local or regional level, where true accountability, both in a political sense and in an economic sense, can be found.

The approach that we're taking, as I mentioned before, is a collaborative one, involving state government, local government and the water industry and the submission identifies that we've established a memorandum of agreement and we're looking at the significant issues of regulation and whilst there might be a belief that institutional change is the basis to the solution of the problems that might be evident, we think there's more to it than simply that. The regulatory environment that overlays the operations of the water industry themselves are ripe for reform and change. They do not focus sufficiently on the needs for a performance-based system or the setting of targets that providers should meet. Only in the event that they cannot meet those performance targets is there justification for intervention that

might see the imposition of other institutional arrangements, or for that matter, other change.

So we were looking at regulatory reform. We're assisting the water sector, recognising across, you know, the diverse nature of the providers in Queensland, that risk assessment is essential to any determinations of actions. That's the basis on which priority actions can be identified. Those actions obviously can look then to what investment is needed in either improved maintenance or the provision or augmentation of supply and the determination of pricing arrangements. Overlaying all of this is the significant issue of workforce skills and capability. It is an ageing workforce that is present in the water sector in our state. Given the new requirements in terms of water quality, water security and asset management and the like, we are short on skills and we are very actively involved with our partners, Queensland Water, in a skills formation strategy to deal with that problem.

I'd conclude by saying that we are taking a very proactive approach to reform. We've identified a set of principles that are underpinning our approach to that. We're engaging actively with the state government and believe that in that way we can start to make changes that reflect diversity, are therefore tailored to the needs of various communities in a way that will be appropriate but also accepted, and fully engage those communities in the future supply of their water needs. I'll leave it at that.

**DR CRAIK:** Okay, thanks very much. Thanks very much, Greg, and thanks for your submission that's very helpful and detailed. If I could start on the issue of supply augmentation. Your submission notes that supply augmentation is determined jointly by the local government and the state. Can you explain precisely how those sorts of decisions are made and if you think there's scope to improve how those decisions are made?

**MR HOFFMAN (LGAQ):** I guess I'll just seek clarification. The augmentation around bulk supply or the augmentation around distribution?

**DR CRAIK:** Well, bulk supply, really.

**MR HOFFMAN (LGAQ):** Bulk supply?

**DR CRAIK:** And outside of South East Queensland I guess mostly I'm talking about, yes.

**MR HOFFMAN (LGAQ):** Sure. I guess the best way to describe it is the drivers are a planning process that requires councils, and it always has, in the water supply area to produce total management plans for their water supply systems that have at least a 10-year focus. That has been for many years now a regulatory requirement, and it has been based on those plans that local governments have been - are able then

to make their representations to state government for the provision of subsidies for the provision of whatever that augmentation happens to be. The state government is also involved in bulk water supply in its own right. So you have a combination - and I'm talking here, as requested, outside of South East Queensland - - -

**DR CRAIK:** Sure.

**MR HOFFMAN (LGAQ):** - - - state governments' bulk water supply, called SunWater, and local governments' individual owned bulk schemes. So councils are required to have their long-term plans, submit those plans and demonstrate to government they have them in place. New requirements have recently been enacted around a more extensive community planning process which, if you like, supplements the total management planning process and requires councils to more fully align their infrastructure plans with their financial plans to enable not only them in the determination of what it is they might do but to enable a state government to have some more confidence in their capacity to respond to what their future needs are. So I'm just talking there about the mechanics of the process.

The decisions about augmentation will rest with councils but in a number of instances the state government has augmented its own schemes to enable water provision, which is a combination of not only water supply for domestic or urban water supply purposes but for industry. Significant investment in the state has been driven on that basis, with urban water supply being, if you like, a secondary but essential consideration. So it's a process of both state and local government but primarily the decisions have been taken by the state because to this point the state has significantly subsidised the augmentation.

**DR CRAIK:** So that the pricing, the local pricing, isn't sufficient to fund the augmentation normally, so it's not cost-recovery basis.

**MR HOFFMAN (LGAQ):** It hasn't been.

**DR CRAIK:** A full cost-recovery basis, yes.

**MR HOFFMAN (LGAQ):** But 18 months ago the state government announced that it was removing the subsidy scheme that had seen a provision of some 40 per cent subsidy to those augmented or new schemes. That, therefore, is driving significant moves in pricing. Any developments or new schemes that are required as of now and into the future will not receive that subsidy. That is driving significant moves in pricing already, particularly in the growth areas of the state, excluding South East Queensland but along the coastal centres. The coastal cities that are growing at a significant rate now looking to augment their supplies will do so on a very different cost basis.

**DR CRAIK:** Yes, we have seen some discussion in Queensland - in Townsville, I should say, about that.

**MR HOFFMAN (LGAQ):** Well, quite an interesting debate where the local - the council was moving to introduce a pricing regime in line with principles established by the Commonwealth, and expected through state government to do so, resulting in a very significant move in pricing with protests from local residents and consumers to the extent that the state government excused the council from having to meet those obligations; a policy position which surprised us, to be honest.

**DR CRAIK:** So what's happening now in Townsville? Are they going to change the process?

**MR HOFFMAN (LGAQ):** Well, they were moving to the full implementation of a two-part tariff; in fact, belatedly so, compared to other water supply providers, which would move prices significantly, generating the protests at the local level. In fact a street march of some 1000 people occurred a month or so ago at the time when state cabinet was based in Townsville, the result of which was the state government relieving the council of that obligation, suggesting it adopt costs-reflective pricing but not necessarily - - -

**DR CRAIK:** Full costs recovery.

**MR HOFFMAN (LGAQ):** - - - full costs recovery through a more traditional two-part tariff.

**DR CRAIK:** So is the Townsville council changing the pricing regime?

**MR HOFFMAN (LGAQ):** It is. I guess that's the politics of the issue both for the state government and the local government.

**DR CRAIK:** Okay, thanks. One of the things you mentioned in your submission is that local governments tend to use a competitive tendering process for the construction of new facilities, but recently alliance contracts have been used by the state government, and there is a comment in the submission: "It is debateable where the best value is achieved." Can you explain what the key differences between the alliance contracts and the competitive tendering are, and why the alliance contracts aren't as efficient as the competitive tendering?

**MR HOFFMAN (LGAQ):** Competitive tendering is perhaps the more traditional approach, where the scheme requirements are specified, taken to the market, and interested parties make their submissions, and decisions are made as a consequence of that. The alliance approach is where negotiated arrangements might apply that seek to have different risk profiles and responsibilities. In other words, the risk



might not necessarily lie entirely with the water provider, in the case of council in the traditional competitive tendering arrangement, but the risk and rewards are shared through an alliance approach. This is the approach taken in a number of infrastructure provisions. In the area of roads: toll roads, tunnels, and the like. There have been some interesting results in that space in the past 12, 24 months, particularly in Queensland, in Brisbane, in relation to the CLEM7 tunnel.

The point in the submission is we get to see whether those arrangements do provide best value or, importantly, whether they are in fact sustainable and, in the event that they cannot be sustained, what the consequences will be. It's not to say they don't have a place, but it is begging the question as to what are the implications, in the first instance, for the investors who are involved in the alliance arrangement with the government entity, whatever it may be and, if they aren't successful, then what are the implications for - in other words, we know the implications under a competitive tendering model, we don't know the consequences of alliance based modelling.

I might add that there are some other variations which we have a little more belief can work. Recognising the constraints on rule of regional and local governments, in terms of their capacity to undertake augmentation in an effective way, the Local Government Association has joint-ventured with the Queensland Treasury Corporation and the state government body responsible for the funding of its infrastructure, both state government and local government. We have created a company called Local Government Infrastructure Services for the purpose of providing the capacity to local government and, for that matter, to state governments, but predominantly local governments, in a new form of procurement for significant infrastructure.

What that entity does is it brings together (1) the financial expertise of the Queensland Treasury Corporation, but also looks to how, in an effective way, you can look to the better provision or the alternative means by which you can provide infrastructure. LGIS has recently entered into a contract with the Whitsunday Regional Council for the construction and operation of a large sewerage treatment plant. The council was not able itself, with its own resources, to do that. They have entered into a contract with LGIS, which will build and operate that facility, bringing not just financial capacity but also significant operational capacity which the council did not itself have. That arrangement will operate for - off the top of my head I can't remember the years for which the initial arrangements are in place. It is a form of alliancing, there is no doubt about that, but it is an outsourced arrangement to an entity not operating solely in the private sector, but bringing expertise to the council to enable that objective to be met.

The LGIS, some 18 months ago, proposed to the state government a significant bulk purchasing arrangement for the upgrade of 100 sewerage treatment plants across

the state. They needed to be upgraded to meet new effluent discharge standards. That work done individually by the councils was at a cost - again, I am trying to recall the figure - two to three billion dollars was the cost. The proposal put to government was that LGIS could do the work by bulking up the task and organising the work to be done on a regional basis or a sectoral basis; in other words, bringing expertise to the procurement process and the performance of the work. That was going to save in the order of 300 to 400 million dollars to the state in terms of what then was its subsidy obligation to the work.

The state government did not take up that offer, more to do with the implications of the work of the scale that was involved at the time and the cost implications of doing it in that efficient way. Subsequent to that, the state withdrew its offer of subsidy in any event, so it saved itself that obligation. The work still needs to be done and the cost will be borne by the provider. I am making the point more though about the mechanism by which the procurement could be significantly enhanced, and I think that is a demonstration of where local government in Queensland is at, in terms of the strategic approach to bulk procurement of infrastructure. But my earlier references to the collaboration with state government is how we approach the identification of what needs to be done, when and where, then using a smarter mechanism to actually do the work is a combination of characteristics that can produce a better result.

**DR CRAIK:** In terms of trying to deal with some of the issues that you have raised in your submission, and similar to some of the issues in New South Wales - you are aware of the Armstrong and Gellatly review of the New South Wales 104 local government providers of regional water. They proposed a number of alternatives, and the one they favoured was a binding alliance model. I would be interested in your views of that sort of approach in Queensland. Is that one of the sorts of things that you are talking about in Queensland, to get some economies of scale, because Queensland seems to have many of the same issues as New South Wales in that respect?

**MR HOFFMAN (LGAQ):** Fundamentally our approach is not dissimilar to that. I might ask my colleague, Simone Talbot, to talk to that, because recently we have been involved in discussions with seven councils in central-western Queensland, exploring the creation of such an alliance, so if you are happy to?

**DR CRAIK:** Okay, yes, thanks.

**MS TALBOT (LGAQ):** As Greg said, last week we were out at Longreach with the Department of Environment and Resource Management, as well as Queensland Water, to discuss the very prospect of the establishment of an alliance between the councils out there, to deal with the issues and challenges they're facing regarding the running of their water businesses. So we definitely see potential for that as an

opportunity. The state government has also indicated that that could be an acceptable response from their perspective. As Greg alluded to, the state has indicated it has no appetite for wholesale reform across the rest of the state following the reforms in South East Queensland.

Of course, I suppose, there's pros and cons to an alliance based approach and essentially it requires political commitment for it to work as well. That meeting that we attended last week was the very first meeting, so it did require a lot of scoping but the councils do seem committed to make it happen. One of the benefits that we're certainly looking at from that perspective is definitely the opportunities to leverage economies of scale and scope, certainly bulk purchasing as well. I suppose the dilemma with applying these sorts of models as well as opposed to other infrastructure classes that councils are responsible for is that the water schemes are separate schemes spread across very diverse communities, so that in itself is a challenge that needs to be addressed.

But, I suppose, just to summarise we see the alliance as providing an approach or a suite of opportunities that the councils can look to leverage from in terms of sharing in terms of sharing of technical staff, expertise, leveraging of scope and scale and also as well pooling of their funding across a region based on need, based on asset need as opposed to political whim in terms of how they are currently investing their funding.

**DR CRAIK:** Is pooling of funding going to be challenge where one council sees that it doesn't get its precise share of the funding it contributes in return?

**MS TALBOT (LGAQ):** Absolutely it is and, as I said, it's politics at the end of day. What we are also trying to leverage off in Queensland is we have a very well-established process through the formation of what we refer to as regional road groups where councils have to pool their funding and also any subsidy they get from the state government into, I suppose, a bucket and then there is a whole prioritisation process that the councils have to go through. It's very rigorous for the application of funding towards priority and need across the region, irrespective of boundaries. So the councils are quite well practised at applying that model to that particular infrastructure class, so what we're trying to do is replicate that for water assets as well.

They've also, within that group as well, established a bureau system for managing the asset across the region. Again, we're looking to expand that to encapsulate their water assets.

**MR HOFFMAN (LGAQ):** There are seven councils involved in this discussion Simone has just referred to. Being familiar, as you are, with the geography of Queensland, it involves Longreach, Barcaldine, Blackall-Tambo, Barcoo, Winton,

Bouliá, Diamantina.

**DR CRAIK:** Big area.

**MR HOFFMAN (LGAQ):** Seven councils and 22 urban water supply schemes. They confront those challenges that I've outlined before in terms of the skills issue with appropriate capacity to do that and when you look at the issues of risk assessment and identification of priority action, what that means for us at investment in terms of augmentation or, for that matter, improved maintenance are all of the issues that are part of this process that we're looking to establish with councils in collaboration with government.

**DR CRAIK:** Do you have a time line for this process or is it as it happens?

**MS TALBOT (LGAQ):** We're at the stage where we're mapping that out at the moment. No doubt it will take many years as we've seen with other arrangements. I think though what has been interesting is we do now have a very strong partnership approach with the state government so collectively local government is getting the same key messages through the association and from the state government and I think there's some very real political drivers for the councils out in those regions in terms of their sustainability, the fact that they cannot sustain their assets taking an individual approach and especially so now that we've got an environment where their subsidies and grants have been greatly diminished. So they're looking for themselves too, "How can we minimise our costs by working smarter and how can we potentially pool whatever available resources we have together for their most efficient use?"

So to be fair I think there was complacency before about their management of their water businesses but I think now there's been some real drivers and DERM has also undertaken some surveys and audits within councils that has been quite revealing in terms of the condition of infrastructure, in terms of lack of long-term planning, reactive maintenance, add on top of that the lack of skills and capacities in house and I think we've got some significant challenges. But what we're seeing - and I think one of the positive things of late is that there is a real awareness now of these challenges and the fact that they must be addressed somehow and obviously councils outside South East Queensland are very aware of the reforms that have happened there, they're not supportive of those reforms because they do want to remain in control of their water businesses. So they see that there is an incentive for them to actually step up and do something because if they don't, the state government may step in and make decisions for them.

**DR CRAIK:** Is there any move or any appetite for any approach like in Victoria where water was taken away from local government and put in government business enterprises on a catchment basis or, I guess, in Tasmania where local government

still remains the shareholder but it's been amalgamated to three.

**MR HOFFMAN (LGAQ):** There is certainly no widespread support for that change. The discussions that we're having with the state government - Simone has rightly identified the drivers for change and the awareness within local government that it has to make changes and that might mean the establishment of regional entities responsible for water supply. Our hope is that that will occur where it can be established that it is an appropriate way to go and politically the councils are prepared to embrace that. I've been around long enough though not to have rose-coloured glasses as to how you get there. What we have said to the state government, and the councils understand this, is that they have to meet certain obligations in terms of security of supply, quality of supply and that has implications for the operation and augmentation of their systems.

If they cannot meet those requirements then that is the trigger for government intervention to put in place different institutional arrangements, whether it's entities of the type you've just referred to or something else. It is our view that we would rather see that approach, in other words, not assume that there is a model that can be universally applied to enable the results or improved situations to be automatically achieved. In other words, have a performance based approach to what needs to be done, meet those performance requirements and that's your obligation. If you can't, then that begs the question: what is the better way in which it can be done? That then leaves the decision or the consequence of decisions made or not made at the local level where it should be. If the community is able to make those decisions at a local government level or a regional level to produce results, fine. If they can't, for whatever reasons, there's a legitimate position for intervention with some other approach.

**DR CRAIK:** Sure. Can I discuss now a bit the regulation. You said the MOA you've got with the government and you're looking at issues in relation to regulation. What are the key aspects of the regulation that you're actually looking at and what are you proposing as an alternative? I guess, as a part of that, is rationalisation of the regulators part of that whole issue?

**MS TALBOT (LGAQ):** We're still working through the detail with the government of that regulation but I think, to summarise, the framework that exists in Queensland is very much based on multiple plans, plans that often duplicate requirements that are extremely onerous and that, at the end of the day, sit on the shelf and are not operationalised. So there is this significant amount of time spent by water service providers planning and doing plans for the sake of plans and it's triggered purely as a compliance task, rather than documents that will help inform decision-making or good business planning.

I think after many years of that approach and not seeing any improvement, the

state is questioning itself as to, "Okay. We need to take a different tack," and so the most recent discussions that we have had with our state government colleagues has very much been aligning the regulatory process on an outcomes based approach, as Greg was indicating, that there would be set performance targets, key KPIs established and that justification for not achieving those performance targets over a number of years would have to be justified and if it's trending that the council is not doing a good job, then that's justification for intervention. But I suppose that's it in summary, Wendy. Just more an outcomes based approach.

**DR CRAIK:** Is there a multiplicity of regulators and do you think we should move to fewer, more streamlined?

**MR HOFFMAN (LGAQ):** In the submission we identify that some three years ago when the issue of reporting to government came into focus, the demands on water service providers to report to government, we identified in Queensland that there were, I think, over 600 elements of reporting that had to be done on an annual basis to nine government agencies, multiple reports. I can't recall the numbers.

**DR CRAIK:** Yes, I read that in your report.

**MR HOFFMAN (LGAQ):** But it was a revelation to us all, particularly to government, and it begged the question, "Well, what do you do with this information?" So there were multiple agencies involved with that reporting task. What value did it add? That has now been rationalised not only at a state level, but it's also providing the basis of reporting to the Commonwealth and the submission identifies that there is still overlap with the Commonwealth. The Bureau of Meteorology has recently created obligations and ABS obligations.

**DR CRAIK:** So has your system been adopted nationally? It seemed to me a very sensible approach, what you had done, and I just wondered whether that had been promoted elsewhere in Australia?

**MS TALBOT (LGAQ):** No. At this stage it is purely Queensland based, however, we are getting a lot of positive reaction from councils, from the various state government departments. Certainly one of the things we're looking to do as well is start to utilise that data, (1), to apply pressure in terms of community awareness of how councils are performing with regard to their water businesses and also using it as, I suppose, a management tool within groups of councils so they can compare like situations between themselves. I know there's always the debate over benchmarking and the value of that, but the system does allow the data to be presented in such a way that it's a like council in terms of the number of schemes, the description of their schemes, their geographic commonalities and that sort of thing. But, no, at this stage it's just Queensland based.

**DR CRAIK:** If I could just finish, because we're running out of time, on the issue of pricing. I'd be interested in the degree of flexibility that local water utilities have in setting prices. I mean, do they make the decisions all by themselves and how often do they set those prices and I guess your submission points out it's difficult for them to fully recover the costs of capital expenditure, so why is that?

**MR HOFFMAN (LGAQ):** They do make those decisions themselves. There is no state government requirement to have pricing endorsed or approved at a state level and they will make those potentially on an annual basis as they set the rates and charges on an annual basis. Simone might elaborate a bit more on what is being done to try to improve the approach to price assessment. But your question at the end there about their ability to pay and the challenges that that provides, again recognising the dispersal of the systems across the state and the small scale at which a number of those systems operate, it has been near on impossible for a number of communities to be able to afford on a full cost recovery basis what is involved.

The state government, in addition to, if you like, that standard 40 per cent subsidy scheme that had operated for many years but has now withdrawn, had another scheme called SCAP, the Small Communities Assistance Program. What that funding scheme did was to potentially provide much higher levels of subsidy for construction and augmentation of water and sewerage treatment facilities in those small communities. The basis of its operation was to say, "Well, what is the average cost of water supply across the state? What would the cost be," in a particular scheme area that it was looking to augment or construct anew and then to provide a subsidy that brought the cost down to the consumer to that state average.

So that was about trying to provide a means to ensure that those communities could have a safe drinking water supply at a cost that was not unreasonable on the basis of a state average. That scheme has likewise been abandoned. There is a replacement scheme yet to be announced in terms of how it will operate. That is in the offing, though there is debate as to whether it will include water and sewerage. We have argued quite strongly that it needs to because if a water supply was to cost a remote regional community \$2000 to \$3000 a year or more, then, given the circumstances of those communities and the capacity of the individuals in those communities either for domestic supply or business and commercial supply, it would be untenable.

**DR CRAIK:** Yes, I understand that. Yes, okay. I think we've just about run out of time, in fact we've gone over, but thanks very much, both of you. I greatly appreciate you coming to Melbourne for this.

**MR HOFFMAN (LGAQ):** I'll leave you with those. Thank you.

**DR CRAIK:** Our next appearances from John Feil and Jessamine Lumley from the National Competition Council. I see more of you at public hearings, John, than I see you anywhere else.

**MR FEIL (NCC):** Yes.

**DR CRAIK:** Can you state your name and position for the record, and then if you have a brief opening statement.

**MR FEIL (NCC):** Thank you. My name is John Feil, my colleague is Jessamine Lumley, we are both from the National Competition Council. You have our written submission. In that submission we set out briefly the role of the National Competition Council in relation to third-party access to infrastructure and in particular in relation to water. We have set out a little bit of a history of our involvement, or the involvement of the National Access Regime under Part IIIA of the Trade Practices Act and how that has been applied to water infrastructure to date.

There are really three specific examples, two of which are probably relevant and one is not. Sydney Services or Services Sydney was an application for declaration under Part IIIA that was recommended by the council and accepted by the minister, and led to the sewerage system in Sydney being subject to third-party access. The second case we set out is Lakes R Us, which is the one I would suggest is not all that relevant. We recommended against declaration for a variety of reasons and that was accepted, so it didn't proceed. The third example we mention is the certification of the Water Industry Competition Act in New South Wales which, following the Sydney Services declaration, the New South Wales' government proceeded to devise a regulatory scheme for third-party access to the same infrastructure as had been declared. As a result of that it was brought to the council for certification as an effective regime. We recommended that it be certified, it was and, as a result of that, that over-topped the declaration proceeding and the minister, on our recommendation, revoked the declaration. The history set out is of some relevance to you and represents the status quo in respect of third-party access to the monopoly infrastructure.

The thrust that we put on our submissions, from our experience, is that the National Access Regime is likely to be reasonably effective in the short-term: it's a flexible scheme, it doesn't apply until there is a declaration, and even when declaration occurs there is no major regulatory impost unless there is a request for access and, even in those circumstances, unless there is actually a disagreement between the service provider and the third-party. The primacy is under all, throughout that process on commercial negotiations, to arrive at reasonable access terms. The benefit of declaration to access seekers is if they are unable to arrive at those terms, they then can have recourse to arbitration of specific access disputes by the ACCC. The scheme is flexible, in that it needn't touch where there are



commercial arrangements in place. Even where it is required for some regulatory involvement, it is on a case by case basis and operates in what, in the scheme of regulation, is a relatively light-handed way, with a negotiation and largely in private between the parties. It deals with one or two specific disputes and moves on.

I think in our submission we did point out that there may be one of the declaration criteria that could be problematic when we were dealing with water reticulation or water transport services in smaller centres. One of the requirements of the declaration criteria is that the facility involved be nationally significant. It may be that in some smaller centres that criteria may be difficult to reach. The low watermark for national significance, at the moment, is one that was set recently, and relates to a sugar cane railway in Queensland where the council took the view that it was not nationally significant. If you delve into our recommendation on that you will see that there were two reasons: one was sheer size and the second one was that it operated very much isolated from the rest of the cane operations in Queensland. So it may be the book is still open on whether or not a smaller system would meet the national significance test. But that we highlight as a potential problem.

In the medium to long term, we do, however, wonder whether the National Regime, the default regime under Part IIIA, might be insufficient. We think there are two reasons for that: (1) it does involve this two-stage process, with the declaration of the facility as one to which the regime applies, and then a negotiate/arbitrate arrangement. If as a result of the study you are undertaking now or, going into the future, parties were to come to a reasonably clear view on what were the monopoly infrastructure items that you needed to potentially be able to access to improve competition in the competitive or potentially competitive parts of the market, one option might be simply to determine that and provide an access regime of some form that applies to those facilities, rather than having to go through the two-stage test.

If it were, it might be relatively obvious, that the criteria are met, there is potential for that process to take a little bit more time than it should, even under the revised arrangements, and it is not necessarily an inexpensive activity. So it is obvious to everybody, from an independent study, that certain facilities need to be designated in some way as open to some form of access regulation. Then once you are certain of that, it might be logical to just proceed rather than providing for the two-stage test.

We also wonder whether negotiate/arbitrate is in some cases sufficient. It has the great benefit of flexibility, but it is to some degree unpredictable, because each dispute could be novel. If indeed everyone really wants access to a specific service and the only real interest is in price, some form of move beyond negotiate/arbitrate might be necessary. I think at this stage we would say that, how much further than negotiate/arbitrate you need to go is a moot point. It is a little hard to determine, because there really hasn't been a significant history or for that matter, at least, there

may be latent demand for access, but it hasn't been obvious. I think the risk of going beyond negotiate/arbitrate is that you have locked in the mechanism in a way that you won't have that flexibility. So we think that is something you might want to tease out further as you proceed.

If there was to be a move towards a more direct form of regulation, perhaps without the front end of Part IIIA, the declaration phase, we think that there is potentially a precedent in some of the approaches taken in the gas sector, where although each state and territory has retained its own individual law, the laws are identical. It is adopted on the cooperative regulation approach with, ideally, one state taking the lead and other states adopting the same legislation, so that any party that wants to enter and get access under an arrangement in New South Wales would face the same rules as Queensland, face the same rules as Victoria and the like. With that, potentially going to reduce costs for everybody and lead to a better scheme, it also gets around some issues around whether or not the Commonwealth should be regulating in this area.

However, our experience to date with the one state access scheme that has been developed, which is the New South Wales' one, is we do wonder whether a scheme that simply mimics Part IIIA, with a different statute, with a different regulator, but doesn't add anything more, is really worthwhile. We think it would be a retrograde step just to mimic Part IIIA in each state, maintaining a declaration role, and a negotiate/arbitrate and simply changing the name of the regulator. We think if that is all that is envisaged, Part IIIA does that quite sufficiently. If, however, you could move forward without a declaration phase and simply designate, then that would be an improvement. Certainly something that moved beyond negotiate/arbitrate would have to be done would have to be done outside the Part IIIA arrangements.

So that's essentially what we outline for you in our submission. It is a question about whether we know enough about what needs to be regulated in what way and for what services to make the judgments now or as a result of your inquiry. I think if you were confident that that was the case then you probably are in a position to recommend a way forward that perhaps is an advance on the national - the default national access regime. If you are not, then we think that rather than develop something independent you'd be better to stick with what applies to a range of infrastructure across a range of states, a range of services rather than have the states nipping off in their own direction or, for that matter, following the WICA, the New South Wales example, which we - in the end we recommended certification because we thought it met the criteria. But in reality, it's a pretty minimal advance, if any, on what was otherwise available under Part IIIA.

**DR CRAIK:** Okay. Thanks very much, John, thanks a lot. I guess WICA does slightly more than provide access too, it's a licensing regime for some other distributed kinds of - - -

**MR FEIL (NCC):** We're really concentrating on the access part of it.

**DR CRAIK:** On the access bit, yes.

**MR FEIL (NCC):** Certainly there was a need - even with the declaration of the Sydney sewers there was an incompleteness in that - my recollection is that while the licensing regime in New South Wales did contemplate other parties perhaps having a licence to operate some sewerage systems, wasn't actually able to get a licence. So there needed to be some advancement. But those things are normally taken care of relatively straightforwardly.

**DR CRAIK:** Yes, okay. No, thanks very much for your submission. I guess you've sort of raised some of these issues. I mean do you really think that declaration - I mean I take your point about putting in place some designated scheme that covers all monopoly infrastructure in the water sector, if we can identify what that might be. But do you think if that's - if we can't do that is declaration a feasible and sort of reasonable option for parties seeking access? I mean it has the potential to be long, costly and drawn out.

**MR FEIL (NCC):** We are doing our best to remove the long drawn out.

**DR CRAIK:** I understand that.

**MR FEIL (NCC):** I'm not sure that anyone in the water sector is willing to pay what some other sectors are to avoid the tribunal or the council being in a position to answer on declaration. But I think the advantage - subject to the potential hurdle around national significance - which isn't a long drawn out question, it's just are they big enough - and you would expect that most of the access requests, at least initially, would be in respect of larger schemes that probably do fall inside the criteria. Our target is now to deal with declaration requests within six months. Even if they go on appeal, the appeals are no longer a re-hearing with fresh evidence, so there should be a shorter period; I'd hope that they'd be somewhat less contentious.

In the end while some incumbents may not particularly want to have to provide access on regulated terms I think the notion that they remain integrated monopolists from top to tail of the business is probably drifting into the back. I think there's much more government support - even New South Wales has moved to a situation where while initially it wasn't a big supporter of the declaration of the sewerage system of Sydney Water it did move forward with WICA. Certainly we certified that regime on the base of assurance that they intended to promote competition rather than substitute something that provided less. So I think - you know, I don't think that time is necessarily a major hurdle. I think there is still some advantage in a declaration-like process or something that applies similar criteria, because you don't

want to extend regulation to where it's not necessary.

**DR CRAIK:** Yes.

**MR FEIL (NCC):** If you start applying it without some consideration of whether there are natural monopoly characteristics, whether it will - access will promote competition in an up or downstream market you could end up regulating a lot more than actually necessary, and potentially crowd out competitive options. So I think either you rely on declaration or you rely on an inquiry such as yours applying the same sort of broad criteria and identify what might be clearly in. You can always leave the fringe to Part IIIA. But I think in your issues paper you identified a set of stages in the process. It seemed to me, that at least broadly described, two of those were pretty clearly areas where access was likely to be necessary and the rest weren't. Now, where you drive the boundary for it is a difficult question.

**DR CRAIK:** It's the tricky bit, yes.

**MR FEIL (NCC):** But that's your issue at this point. In the end, I think logically, people that know the industry will advise where the boundary should be.

**DR CRAIK:** Yes. Have you had any interest expressed to you - people seeking information on access issues in relation to water infrastructure?

**MR FEIL (NCC):** Not in water infrastructure.

**DR CRAIK:** Other than the ones you've identified?

**MR FEIL (NCC):** Other than the ones, no.

**DR CRAIK:** No? Yes.

**MR FEIL (NCC):** I think Sydney or Services Sydney probably was a scout very much at the forefront of where things were going. In the end their project didn't proceed but it started the process that led to WICA and I think WICA has sort of started more of a process among the other states about what might be necessary. I guess we were a little concerned initially that states might take the WICA model and try and replicate it. As I said before, that would essentially end up with a whole lot of parochial Part IIIA equivalents, which we see no benefit in it at all.

**DR CRAIK:** Yes, okay. Are you aware of any regulatory arrangements about third-party access in relation to water anywhere else in the world? Has that come to your attention?

**MR FEIL (NCC):** Not regulated in this way. A number of franchise agreements

that operate in Europe have access elements to them but Australia, I think, is at the front end of a number of issues in the water sector.

**DR CRAIK:** Yes.

**MR FEIL (NCC):** And certainly this, I think, is one of them.

**DR CRAIK:** Okay. You've commented on WICA. Are there any strengths in it? You comment on the sort of weaknesses of it, that it is pretty much a local replication of IIIA, are there any strengths in it that you see?

**MR FEIL (NCC):** Well, I guess it inherits some of the strengths of their own Part IIIA.

**DR CRAIK:** Yes, but in addition to that?

**MR FEIL (NCC):** Beyond that, probably not.

**DR CRAIK:** Yes.

**MR FEIL (NCC):** I guess that - probably to be fair there is a degree of integration with the rest of the licensing and the regulatory system. That possibly leads to more of a one-stop shop. In that way I'm sure the commercial parties who might want to use it may be able to tell you something about that. I note the disadvantages of a scheme that's developed within one state, or even a series of schemes developed within one state, is the potential - notwithstanding the best will in the world we have different regulators. You will get a divergence of approach. Whereas if you have the central scheme, which in the end is a cooperative scheme of all Australian governments, it's not a Commonwealth imposition, you will have one regulator dealing with the issues and you can expect much more consistency in result. Now, all regulators do make a significant effort to communicate in a way that the issues are thought about collectively, but each regulator has some unique features. So I think, on balance, you are more likely to get a consistent approach nationally than you are with state regimes.

**DR CRAIK:** What do you see would be the downsides of kind of a designation approach, designated - - -

**MR FEIL (NCC):** Well, if you designate the wrong thing it would be a bad start.

**DR CRAIK:** Yes.

**MR FEIL (NCC):** I think if it can be properly refined and the designation is done once on the basis of similar criteria to those in Part IIIA there's always the risk of

error, but if you're applying the same rules - that's there and won't change. It potentially would get past the small not nationally significant facilities. I think if you designate certain facilities but don't exclude Part IIIA from anything that's beyond that, you still have recourse to Part IIIA if there's a fringe issue. So if you stopped short of where you really needed to to provide access there's always another chance to amend the designation. I think the real question would be whether we know enough yet about how people might seek to access these arrangements.

If anyone had asked five years ago how Sydney Services or Services Sydney might have sought access, you probably would have thought about an arrangement where they could input into - sorry, in that case extract product from the sewerage system for processing. You probably wouldn't have thought of them also trying to sell a service to the household. Now, they needed to do that to get within the operation of Part IIIA. But if you'd - if that was their actual - the model they really desired, the risk of a designation is that it might not designate the right services. Until you have a better idea of how access is going to evolve from being a build something, plug it in or develop a subdivision and plug that into something at each end, there is a risk that you foreclose options. I think that's less if you designate on a not exclusive basis, so you leave Part IIIA - - -

**DR CRAIK:** In parts, yes.

**MR FEIL (NCC):** - - - to apply to whatever you didn't designate.

**DR CRAIK:** Yes.

**MR FEIL (NCC):** So the ones who have got the bespoke requirement can come through the national scheme, those that want to access the designated facilities have a advance regulatory scheme. So it's really an ex post versus ex ante regulation. I guess the more you can now look at ex post and answer the question then the safer you are to designate.

**DR CRAIK:** Yes.

**MR FEIL (NCC):** No doubt, obviously, you rely on the national scheme.

**DR CRAIK:** Yes. Do you know why New South Wales - sorry?

**MS LUMLEY (NCC):** I was just going to add also, if infrastructure is designated from the outset you probably want a clear process to revoke that designation if circumstances changed - - -

**DR CRAIK:** Sure. Yes, that's right, yes.

**MS LUMLEY (NCC):** - - - so that was transparent.

**DR CRAIK:** Yes, that's right. Do you know why New South Wales went the way they did, the sort of case by case approach as opposed to a sort of designated approach or maybe they didn't even consider it?

**MR FEIL (NCC):** I don't think they considered it. Their initial application to WICA is exactly the scope of the Part IIIA. So it seems improbable that getting the Part IIIA declaration revoked wasn't part of the idea, and that's probably sensible, if it's going to be little more than duplicated. My assumption would be that they didn't want to go any further than they had to initially. They do have a mechanism for adding. Unlike Part IIIA it doesn't have a history of operating.

**DR CRAIK:** Yes. Yes, that's right.

**MR FEIL (NCC):** But I think - you know, we're not in a position to read minds but I think the coextensivity probably suggests that at least part of the motivation was to bring it within the regime. Whether they could have or should have gone further - you know, there didn't appear to be a great cry for additional arrangements.

**DR CRAIK:** No.

**MR FEIL (NCC):** You've spoken to IPART, I think?

**DR CRAIK:** Yes, we have.

**MR FEIL (NCC):** I think we're reasonably confident that IPART operates in a way that if there was another request to broaden the scope that met the criteria then they'd recommend in favour.

**DR CRAIK:** Okay, all right. Well, thank you. Thanks very much, John, thanks very much, Jessamine. We will now break for morning tea and resume at 11 o'clock. Thank you.

**DR CRAIK:** We might resume. Gavin, could I ask you and your colleague to state your name and position for the record and then if you'd like to make a brief opening statement, we'd be happy to hear from you. Thank you.

**MR HANLON (CW):** Gavin Hanlon, managing director of Coliban Water.

**MR O'SHEA (CW):** And Jarrah O'Shea, manager of economics and pricing.

**MR HANLON (CW):** Thank you for the opportunity. Both Jarrah and I will provide a brief overview of Coliban Water, as a regional corporation, some challenges we've had in recent times and some opportunities we see going forward. I'll provide a general overview and I'll let Jarrah go through the detail of where we see some opportunities. A little bit about Coliban Water. We are a statutory regional corporation based in Bendigo that supply water and waste water services to about 50 towns, going from Echuca in the north to Trentham in the south. We supply water from seven separate supply systems, some of which are interconnected, and we also supply recycled water in a number of towns to substitute potable water as well, particularly in Bendigo.

Our corporation has a history of outsourcing the majority of our operations. We have a PPP with a treatment plant and also a BOOT contract with one of our larger treatment plants as well, as well as outsourcing the majority of our operations. We believe it represents an efficient way of doing business and that has been demonstrated on a number of the performance reports over the last couple of years. In recent times - and when I say "recent times", in the last 10 years or so - our inflows have reduced by about 63 per cent against the long-term average and even though in this year rainfall is substantially above average, our inflows have only in the last week reached the long-term average of inflows. So, on average, over the last 10 years, there's been quite a substantial reduction.

Those reductions have actually meant we've had to look at supplying water quite differently. The organisation has invested heavily in recycling water to offset potable water, but also a neighbouring corporation invested in a pipeline to give us access to the broader water market. We have a range of bulk entitlements and a range of shares and we rely and have relied on the temporary water market for the last couple of years, although we may not need to for the next couple of years. With that comes many opportunities and challenges as well. We now have choice as to when, how and where we take water from, but also where we store it and that presents challenges around how we determine what is the least cost option for our organisation and supplying water to our customers, and hence the main reason we made a submission.

Each of those different supply options have different cost characteristics, different water quality characteristics, there are different treatment costs and there



are different constraints in delivery, constraints in treatment plants as well, meaning that our business with interconnectivity has become incredibly more complex in the last couple of years, so much so that it's meant we've had to substantially change the way we operate our business as well. Before I go any further, I think it's appropriate that I hand to Jarrah now to go through what some of those challenges are, particularly from an economic point of view.

**MR O'SHEA (CW):** Thanks, Gavin. So economic optimisation is the process that we're embarking on and we envisage that that will help us minimise our economic costs, while endeavouring to meet an unconstrained level of demand. Traditionally a cost-benefit analysis might have entailed looking at the cost of treatment and reticulation, pumping and even water purchases. However, these days we also must consider the cost of reducing demand below unconstrained levels, recognising that that does impose a cost on customers and also the lost revenue that that entails from the business's perspective. However, we also need to consider the cost of drawing down storages. I think it's this last point which represents the very significant change in thinking, compared to the way water businesses have operated in the past. Historically water would have been considered valueless or even valued at net cost.

Coliban Water has learned from TrustPower in New Zealand, a medium-sized hydro-electric company who values its water in storage based on the level of its dam, a nearly full dam decreases the marginal value in storage and a low dam increases the value. In a hydro-electric setting, it is this value which guides decisions to generate or otherwise on a daily or hourly basis. A business such as TrustPower compares the marginal value of water in storages with the prevailing market price and uses this to determine whether or not to generate at any given moment. In the water industry, the value of water drawn down is an economic cost that must be considered and given equal weighting amongst the traditional costs.

Up until very recently, water authorities obtained their water from local sources, generally comprising river extractions, catchments, storages or ground water. In some cases authorities relied on a number of these different methods, but usually only one for each distinct supply system. Economic analysis of supply infrastructure options was generally based on the net present value of two or more engineering solutions. As Gavin mentioned, the changing climate in central Victoria has brought such dramatic reductions in inflows that the available supply was insufficient to meet even the nominal demands of critical human needs.

Coliban Water, faced with massive inflow reductions, despite the fact that our inflows have only just reached average - water authorities have been looking outside their traditional methods of supply to meet water demand and it is important to note that by 2013 every single urban water authority in Victoria will be obtaining water from another authority. It is this interconnectivity which has brought us new water supply opportunities; it has added a level of complexity with water trading and

authorities can easily suffer impairment losses if the value of water goes down on the temporary market, and these can be in the millions of dollars. On the other hand though, interconnectivity is a fantastic opportunity and is essential for insuring the allocative efficiency of water.

An additional aim of optimisation is to lower the cost of service provision and to lower the costs to customers by minimising long-run marginal costs. In addition to the usual inclusion of brought-forward capital costs, the long-run marginal costs must also include the cost to consumers of having constrained demand and the cost of drawing down the level of storages. Ultimately, including costs customers face such as restrictions on the cost the authority faces allows an optimisation model to function properly. There have been numerous studies on the cost to consumers of restrictions, so I won't go over them, but the Productivity Commission and many others have studied this in great detail.

Developing an optimisation model demands a detailed understanding of the operation of the organisation's water supply network, its options, and costs. All these parameters will be fed into a model with the market rules at the time, prevailing market price, and storage levels, and this will then output recommendations regarding water transfers between storages. In the second stage of development an optimisation model will enable forecasting of future inflows and other parameters stochastically to ensure that water authorities are best able to cope with whatever Mother Nature has in store for us.

In order to utilise the full benefits of optimisation Coliban Water would see great benefit in the use of more flexible pricing models. The five-yearly set-and-forget pricing model has served its purpose, but will be incompatible with the sophistication required for an optimisation model. We will use optimisation to give us a better indication of the variable costs and the value of water at given times. This could be used as a mechanism for having variable pricing to reflect the scarcity of water. That said, we are not advocating scarcity pricing, per se, where demand is set using a very strong price lever. Our aim with optimisation is to achieve greater business efficiency whilst supplying unrestricted demand at a price resembling the value of water as opposed to guiding behaviours through pricing.

Coliban Water would be very supportive of any way of applying learnings from outside the water industry. Hydro-electricity companies have very similar optimisation problems and would appear to be well advanced in the concepts, planning, and governance of these. The skill sets required to manage an optimisation model are different and water authorities embarking on this journey will need to adapt to fully realise the benefits of optimisation.

In summary, Coliban Water contends that economic optimisation offers massive benefits to water authorities and will assist authorities in insuring the

sustainable provision of water to customers in the long-term at the lowest possible cost. It will lead to enhanced allocative efficiency. As a government-owned entity, Coliban Water will always obey the rules that are set by its shareholder. It is within these rules that we will seek to optimise our supply to ensure the highest possible service to our customers at the lowest possible cost.

**MR HANLON (CW):** In concluding, our problems and solution are fast moving from engineering problems and solutions to economic problems and solutions, and we feel that there would be great benefit in having a better understanding of value functions of water as opposed to just costs and engineering.

**DR CRAIK:** Thanks very much, Gavin. Thanks, Jarrah. How far are you along this cost optimisation?

**MR HANLON (CW):** We would say we are progressing through the development of a number of models and we are in the process of moving towards a stochastic model, but at the moment we are developing a deterministic model to help better understand how to guide some of our decisions. So relatively early days. We have had a proof-of-concept process finished, and we are now moving into the second phase of that.

**DR CRAIK:** Are any of the other water authorities in Victoria looking at this process?

**MR HANLON (CW):** It is a bit hard for me to speak on their behalf; I'm not really sure. I know there are a couple of others looking at similar-type things and similar problems, particularly those that have multiple choice for supply.

**DR CRAIK:** Okay. I was interested in the comment that, I think it was you who made it, Gavin, that by 2013 every single water authority will be connected with every other single water authority in Victoria.

**MR O'SHEA (CW):** Every authority will be obtaining water via some means from another authority. So it doesn't mean that, I suppose, East Gippsland is connected to Warrnambool, per se, but, yes, every single authority will have purchased some water from outside their own traditional area.

**DR CRAIK:** There is a degree of connection between them. When you talked about this New Zealand power company and the value they place on the water in the dam is based on the market price, is that of electricity or of water, and which water; agricultural water, urban water, or what?

**MR O'SHEA (CW):** TrustPower in New Zealand operates a dam for hydro-electric purposes and, within that sort of setting, water and electricity are almost

interchangeable. So both, really. But the value they place on the water is dependent on the level of the water in their dam, and if the market price exceeds the value that they place on the water, that is when they will make the decision to, effectively, sell into the grid and to generate electricity.

**MR HANLON (CW):** Which aligns very closely with the way we use the market in using our own storage, that's why we were looking at that model.

**DR CRAIK:** Okay, thanks. What do you think the biggest gains are in terms of using productive efficiency for regional water utilities like yours?

**MR HANLON (CW):** Fundamentally it is about supplying water at the least cost in an unrestricted way, so customers have choice. We are not quite at that point yet, but the objective of our model is to do that - the objective of our process, rather than the model itself.

**DR CRAIK:** Can you explain how the prices are set right now for water and who sets it, and then where you actually want to end up, whether you are setting them or someone else?

**MR O'SHEA (CW):** The current model in Victoria is effectively a cost-recovery model, and every three years or five years, as the case may be, the regulator has set the prices that will apply. It's based on the cost that the water authority faces. Moving into this model we will have a lot greater idea of the actual value of the water to us and I think there would be some benefits in moving to a more flexible approach. Precisely what that means at this moment, we're not sure. It is something that we will be working through over the next few years in order to better elucidate this.

**DR CRAIK:** So would you imagine or envisage the regulators still setting the price, or the price schedule, whatever it might be, or would you envisage setting it yourselves, or hope to set it yourselves.

**MR HANLON (CW):** It's very early days, and touching on the role of water policy, which is a bit outside our area to comment on.

**DR CRAIK:** Okay, even though I am sure you must have a preference. Right now, how do you decide where you take water from?

**MR HANLON (CW):** For the last two years we have had a resource team. We have had to have a functional separation inside the organisation, between a resource team that designs and builds and has endorsed an annual operating plan for water requirements for unrestricted demand. We have a water resources committee that looks at when and how we might purchase water on the market to achieve those

objectives. The trading is separated from that, and then the settlement process is separated again, so there is appropriate separation. Certainly during dry times, every fortnight we are all meeting and looking at inflows, consumption, weather patterns, price of water on the market and then making a decision against that pre-endorsed plan as to what we might do to meet those objectives.

In more recent times, even though we now have more water than we ever had before, with the entitlements we bought through the drought, the challenge hasn't gone away; for example, in Eppalock at the moment, which is one of the storages we draw on, in our share of that there are three different types of water, all with different cost characteristics. We have our storages that only have - or towns in the top end of the catchment with only one source of supply, and we have water in Eildon. So the challenge today, even though it is very wet, is still as real as what it was in the middle of the drought.

**DR CRAIK:** Okay. Thanks. In relation to third-party access, the Victorian government, as we understand, is considering the introduction of the state based, third-party access regime, do you support that notion or does Coliban Water have a view about that?

**MR HANLON (CW):** We can talk about some experiences we have had during the drought with regard to something very similar to third-party access. So during the middle of the drought, when we were on quite tight restrictions, stage 4 and stage 4 with a couple of exemptions, we did have some spare capacity in our infrastructure to supply. To achieve what we argued was a greater public good we gave councils and sporting organisations access to our infrastructure they wanted to purchase water on the market to keep sporting fields green and so on; and also if they could demonstrate an employment benefit to the region as a whole. We had 30-plus people participate in that pilot, couple of hundred megalitres sold through our urban system. It worked pretty well as a pilot, particularly in a constrained environment with water.

However, in an unconstrained environment, which we are fast moving into, we believe we've got a little bit more work to do to work through (1) whether it's something that would be - the community and our customers would actually desire, and (2) how we'd actually work through some of the costing challenges we have with shared infrastructure and things of the like. Whether we supported it or not I think it would be determined by whether our customers are demanding it or not.

**DR CRAIK:** Okay. Are you looking at offering or encouraging a process where the regulator, I guess, approves - where you can make different offerings to customers so that they can pay more for guaranteed water security, so that not everybody is subject to the same restrictions, necessarily?

**MR HANLON (CW):** As part of our next regulatory planning cycle, our water

plan, we will be going through an extensive community consultation exercise to determine whether there is a demand for different water products out there. Should that demand be demonstrated we'd try and build that into our next planning process. To date there has been only a couple of large commercials who have expressed an interest but you would say it was only just an interest.

**DR CRAIK:** So residents haven't expressed an interest to be able to access further water to keep their gardens going or whatever, at a price?

**MR HANLON (CW):** In some of the initial market research we did the general feeling in the community, "If our storages are empty we're all happy to pay a little bit extra to share the resource," so a greater community good. So certainly wasn't a demand for that during the middle of the drought. In saying that, we're not sure what attitudes will be two years down the track. As I said, we're about to embark on a community engagement exercise and market research exercise to have a better understanding how beliefs may have changed.

**DR CRAIK:** Which number did you actually pick to look at the - I mean what basis was the number you picked for the cost of restrictions because yes, there's bits and pieces of work around the place but - - -

**MR O'SHEA (CW):** I wasn't actually working at Coliban Water at the time but the number that was chosen was - it was in the vicinity of the prevailing non-residential price of water.

**DR CRAIK:** Okay.

**MR HANLON (CW):** So there's lost revenues, one of way of looking at it, and then extrapolating from some of the other studies that have been done what it might look like for Bendigo and generating a range of numbers from that.

**DR CRAIK:** What do you see the potential benefits might be if you had some kind of third party access regime in Coliban?

**MR HANLON (CW):** I think the discipline of looking at your business - if you had to ring fence a number of things - means a deeper understanding of your business and therefore how you can more efficiently operate. Whether third party access is real or perceived the process of going through those exercises will mean you have a deeper understanding and look for opportunities for efficiency. As to whether it happens or not, well, that's not for us to decide but certainly the process of getting ready for it has introduced some greater business discipline inside certainly our business.

**DR CRAIK:** Do you see any risks?

**MR HANLON (CW):** Certainly when an organisation like ours supply water to 50 towns that range in size from half a dozen people to 100,000 - certainly being able to supply water to those smaller towns at a reasonable cost, provided things like retail-minus were in place for the costing things, maintaining equity of service across a larger region and maintaining a social contract, if you like, with those smaller towns becomes very important. Without water a lot of those smaller towns would just disappear. Clearly that's not something you want in regional Victoria.

**DR CRAIK:** No. Do you see a risk of cherry picking, someone coming - if there was an access regime, someone coming - - -

**MR HANLON (CW):** Well, certainly that's a risk.

**DR CRAIK:** Yes.

**MR HANLON (CW):** Certainly that's a risk.

**DR CRAIK:** Okay. What about postage-stamp pricing? What's your view about that, if you have one?

**MR HANLON (CW):** I think the same - I mean my view is again back around that social contract with the smaller communities, being able to maintain them as part of the regional fabric is incredibly important. How you achieve that objective - there might be several ways of doing it, retail-minus, postage-stamping, whatever it may be. But certainly they're the sort of things we need to discuss, explore, debate, understand better before getting excited about different models.

**DR CRAIK:** Yes. The model you described, I guess, the water-trading model that you used where individual customers could indicate how much extra water they want, how did you determine prices on that?

**MR O'SHEA (CW):** There was a number of options that we considered including, I suppose, the cost of service and the retail-minus type approach. In the end they ended up being quite similar. In the situation where the traditional method of supply was just dam water that basically fell for free, there really is no difference between the two. In a cost-recovery model you would expect that the cost of water is roughly indicative of the costs. So yes, as I said, previously the access price was determined to be very close to the non-residential price at the time.

**DR CRAIK:** Was it only local councils and community or sporting clubs or something? I mean who could do it?

**MR HANLON (CW):** As a pilot we put a bound around and around, made it public good, so schools, sporting clubs, local government and then the broader public

good about keeping people employed as well, so there's a couple of nurseries that also accessed it as well.

**DR CRAIK:** Okay.

**MR HANLON (CW):** We haven't needed to expand it beyond that. In fact, we don't need to run it in an unrestricted environment. We haven't needed to offer - there's no demand for it.

**DR CRAIK:** Had you contemplated expanding it before it poured with rain?

**MR HANLON (CW):** Well, there comes a point in time where you have to evaluate whether we enter the market on behalf of the customers to ease restrictions for everyone or we remain in a constricted environment and let our customers enter the market for themselves. That's the sort of thing we have to evaluate. When there's water we haven't needed to explore that any further than where we got to. I guess we would say that restrictions for regional communities, our communities - and it's better that we get to an unrestricted space and let customers have choice as to how much they use as opposed to saying, "Well, we'll let people enter the market and do it themselves." General urban customers, my feeling would be - there's no demand or real pressure from our customer base to give individual urban customers access a range at this point in time.

**DR CRAIK:** If there was a demand would you see that changing, as opposed to - or offering the possibilities, as opposed to putting in place restrictions?

**MR HANLON (CW):** I think we'd explore a way of trying to service the needs of our customers, whatever that might be, within the rules of the day.

**DR CRAIK:** Are the restrictions the decision of Coliban Water?

**MR HANLON (CW):** Yes. So we have draw-down curves, we have some guidelines around maintaining at least two years of critical human needs in reserve, should we have a couple of years like 2006 and 2008. Then with our draw-down curves and our models we look at how we can ease restrictions or apply restrictions, if need be. However, in more recent times with these sort of exercises our preference would be, where we have interconnectivity, is restrictions would be our last resort.

**DR CRAIK:** Is there a lower level of per capita use now than there was before that you're aware of?

**MR HANLON (CW):** An observation, rather than knowing, at the moment, is that consumption has dropped substantially. Certainly we would say some of that - in fact, a fair component of that - is related to behavioural change and attitudes. A lot



of our region, in particular, has invested heavily in tanks and greywater systems. When it rains every second weekend people are having trouble emptying their tanks at the moment. I guess that's the other component, to reduce consumption at the moment: it's still wet, we're still getting a lot of rain, so things are still green. I think we'll have a better feel if we have a dry spell through February and March, well, we'll have a much better feel for how much of it is actually related to behavioural change. We're designing some - putting some experimental processes in place to actually have a better feel for that when it does dry out. But at the moment we're factoring around the 25 per cent reduction in consumption related to behavioural change.

**DR CRAIK:** Do you encourage things like tanks and greywater systems?

**MR HANLON (CW):** Certainly sustainable use of water is important to all our customers and we've promoted sustainable wise use of water and will continue to do so.

**DR CRAIK:** Is any information provided on the cost of it, relative to the cost of say purchasing water and delivering it?

**MR HANLON (CW):** Well, we certainly haven't put the comparisons up on our web page. I think it's - yes, we haven't put it up on our web page. A little bit hard at the moment to provide a very, very accurate cost for that when we're still working through detailed costings of our third party access type things.

**DR CRAIK:** Do you think there's going to be need for a grid manager in Victoria?

**MR HANLON (CW):** I think it's very hard for us at this point in time to determine that. I think we look at our experience in the past about how we've operated within the market to service those needs we've had under extreme dry and if there's - what constraints we've had have been very, very few and would a grid manager actually benefit or add any efficiency to that? We're one corporation of 19 and it's a bit hard for us to comment on that in isolation. I think it's a bit hard for us to comment on that one.

**DR CRAIK:** Just given the increasing degree of connectedness in Victoria.

**MR HANLON (CW):** Yes. So I mean grid manager also means different things to different people. I think even around my executive table we all have different interpretations of what a grid manager may or may not do and how it relates with other corporations, inter-relates with the market and delivery. But I think our experience so far is that we haven't been constrained or seen any real constraints with the way we've operated to argue really strongly for a grid manager. But again, I think that's a discussion for someone who is looking above little old Coliban Water and looking at how all the water corporations inter-relate with each other.

**DR CRAIK:** Now, you price on full - the regulated price on full costs recovery for you and for all Victorian water authorities?

**MR HANLON (CW):** Yes, that's correct.

**DR CRAIK:** The model where you're separate from local government, do you find that an effective model, a catchment-based model? Is that an effective basis for a model?

**MR HANLON (CW):** Our organisation has a revenue of about 80 million and about a billion dollar asset base. We cut across, I think it's close to 11 to 13 separate local government areas. I think working at a local government scale it would be incredibly hard to demonstrate the efficiencies we can show at the scale which we operate. Having a skills based board certainly means that we're appropriately governed as well. I think it would be very hard at a local government scale - and the skill set required to operate with the sophistication that we are finding ourselves in - would be very difficult.

**DR CRAIK:** Do you have trouble recruiting people with skills, appropriately skilled people?

**MR HANLON (CW):** It depends on the job. In recent times the market has been okay, unless it is a very specialist job, which I think everyone is finding it hard to recruit for. I think one of the benefits of some of our outsourcing model is a number of our bigger contracts are managed by very large companies who can call on expertise from all over the world as needed to very small towns in regional Victoria that we would never have been able to attract that expertise and they have got them on call. So that's one of the other benefits of our outsourcing model.

**DR CRAIK:** So how much do you outsource of your business?

**MR HANLON (CW):** By far the majority, all our operations including revenue services, IT, treatment plants, transmission operations. The only part we really have internally is management of our headworks and our storages and strategic component of business services. Yes, that's about it, really. We're about to embark on a review of that business model. It has been in place for some 10 years now and we're about to embark on what does our business model need to look like into the future. So a number of big contracts are coming up for renewal in the next two years, so now is an appropriate time to have a look at that.

**DR CRAIK:** What would you say were the - where the greater schemes in water reform are to be had in urban water reform?

**MR HANLON (CW):** Well, back to our original objective of providing water at the least cost. We see, from where we sit in our part of the world, that having a much better understanding of the value of water and operating a business around its value and looking at the economics is a challenge that we will need to invest in substantially and where I think the largest gains are.

**DR CRAIK:** Okay, great. Well, thank you. Thanks very much, Gavin. Thanks, Jarrah. Thank you, thanks a lot.

**MR O'SHEA (CW):** Thanks, Wendy.

**DR CRAIK:** So we might follow up with you some more about the model that you're looking at as well.

**MR O'SHEA (CW):** Sure.

**DR CRAIK:** Yes.

**MR O'SHEA (CW):** By all means, sure.

**DR CRAIK:** That's great, thank you.

**DR CRAIK:** Now, we have Alison Joseph. Thanks, Alison. When you're ready could you state your name and position for the record and whatever your representation? Then if you'd like to make a brief opening statement.

**MS JOSEPH:** My name is Alison Joseph and I live at Trott Road in Bullengarook, which is about 65 kilometres from Melbourne, and I am here as a private person. Basically, what I want to do, I'd like to thank the commission for giving me the opportunity to present today. Really, my presentation today is really to provide a case study to the commission. I believe my case and that of many other people in my area demonstrates the failure of independent price regulation in Victoria in the urban water sector and the need for improved customer protection in regards to water and water-related services. I'll just sort of go through my presentation.

Back in mid-2008 I received a bill from Western Water on behalf of Melbourne Water for something called a waterway service. Given that I'm a rural property about 65 kilometres from Melbourne and I'm not connected to any services, I initially ignored the bill thinking it was a mistake. Given that I'm also not connected to electricity if I actually got a bill from an electricity provider I'd find it just as perplexing. I've spent the last two years attempting to fight the bill, and more importantly, find out what service I was supposedly receiving.

I'd like to sort of highlight two statements that have been used to really justify this charge, and my opinion that they're not correct. Firstly, both Melbourne Water and the government had stated that this was the charge that had been paid in Melbourne since the 1920s and it had just been extended to my area. Secondly, that Melbourne Water acquired responsibility for whole-of-catchment management in 2005 and that's what the charge was for. So these charges were - these statements were both contradictory and in my view both of these representations were actually false.

I've spent the last two years reading extensively the history of MMBW, Melbourne Water, and all the legislative basis for charges. I have come to the conclusion that - well, that the charge doesn't have very much of a legal basis, although I did take it to VCAT and VCAT said that it did. What has been charged in Melbourne since the 1920s was the metropolitan drainage charge. This is for the provision and maintenance of drainage infrastructure. Both Melbourne Water and the Essential Services Commission have categorically stated to me that the charge I'm being asked to pay is not for drainage. In fact, there is no drainage infrastructure within about 20 kilometres of my property. They're not responsible for drainage in my area, though a local council is.

But it should be noted that the fee set by Essential Services Commission for this charge was in fact the metropolitan drainage charge, as this is the only relevant prescribed service under the Water Industry Regulatory Order. In fact, under the

Water Industry Regulatory Order 2003 a metropolitan drainage service is described, and is currently described, as a service under Part X of the MMBW Act, which was an act that was repealed in 2007. I later questioned how the Essential Services Commission had set a charge under a repealed act.

In 2005 the area of metropolis - and this is how they claim that the extension happened, they extended the boundaries of "metropolis" under the MMBW Act. No notice was given about that, no-one was consulted about it and a map of that area was never published. But it's on the basis and the basis of this map (*alone*) that Melbourne Water claims it is now responsible for whole-of-catchment management in my area.

Now, I consider this claim to be untrue for a number of reasons. Firstly, in the previous 115 years of existence, Melbourne Water and the MMBW before it had never been responsible for whole-of-catchment management under the MMBW Act. By 2005 the definition of "metropolis", from what I can gather, was largely defunct, having been sort of split up in 1994 with the disaggregation of the three water retailers. In fact, it was the definition of "metropolitan area" in the Water Industry Act which is the relevant definition.

Furthermore, in 1994 when that disaggregation occurred, Melbourne Water actually lost its responsibility for waterways. Prior to that, it had controlled waterways through those waterways being vested in it. In effect, it owned the waterways. With the disaggregation in 1994 and 1995 and a little bit subsequently, those waterways again became crown land and an organisation by the name of Melbourne Parks and Waterways took over the management of waterways in metropolitan Melbourne and then subsequently Parks Victoria gained this responsibility. So you actually have a situation now where people in Melbourne are being charged a Parks Victoria charge, which is otherwise a metropolitan improvement tax, which is for, amongst other things, the maintenance of waterways in metropolitan Melbourne, while at the same time Melbourne Water is apparently charging people for waterway services as well.

After 1994 Melbourne Water was only responsible for water quality and for drainage, but the claim is made that because it expanded its area in 2005, they somehow became a de facto catchment management authority. They then sent 160,000 Victorians, who hadn't been previously billed, a bill for waterway services, including myself I'm miles from the urban growth boundary and don't have any services. What I then discovered was there was virtually no way I could dispute the charge, and that's what I found greatly concerning. Here I've got a corporation I have had nothing to do with send me a bill when they don't provide me a service and they couldn't actually explain to me what the service was for. So I went about disputing the charge and found enormous barriers to me doing so.

I contacted the Energy and Water Ombudsman of Victoria, who initially said that they couldn't do anything as it was outside of their jurisdiction; the Essential Services Commission, who told me that they're not in the business of deciding whether or not people should be charged a bill, but only whether it is cost reflective (but seeing as I couldn't figure out what the service actually was, I'm not too sure how they figured out the costs). Quite concerningly, I had the ACCC tell me that, because of the changes made to the Water Governance Act in 2006 that brought Melbourne Water under the Water Act and abolished the Melbourne Corporation Act, that Melbourne Water was now exempt from the Trade Practices Act and that they had crown immunity and therefore any claims for misleading and deception conduct or unsolicited services could not be brought against them.

Likewise, I initially put an application to the civil list of VCAT under the small claims tribunal under the Fair Trading Act and I was told that I couldn't dispute the charge at the small claims tribunal because I was trying to dispute a charge for a service I didn't receive, which was exactly my point. So eventually I had to apply to the planning and environment list of VCAT. I made an application to them and, although I followed up with them virtually weekly, my application remained unregistered for more than eight months. In the end I lodged a complaint with the chief justice of the Supreme Court about the non-acceptance of my application and a couple of days later, my application was registered.

There was a directions hearing and then on 1 July Melbourne Water attended a hearing and they didn't present any legal argument. They were given another 14 days to present legal argument and again failed to do so. Then 14 days later they were given an extension and they came back and they had the opinion of two QCs, which I thought was quite interesting to come up against two QCs at VCAT. I should point out I have actually tried to get legal representation to go to VCAT. I approached a number of legal firms in the city who had experience in water law, but was told that they had a conflict of interest because they only operated for water authorities.

I found two country lawyers who had experience in the Water Act, but they didn't have a great understanding of the MMBW Act and Water Industry Act, as they only operate in Melbourne. I approached solicitors who had knowledge of administrative appeals, but not the water law and they told me it would cost me about \$10,000 for them to get up to speed on the water law. I found a barrister who would act for me with experience in water law and he suggested it would be \$10,000 to \$15,000. I'm disputing a \$40 charge. So in the end I had to read all the legislation myself and present an argument to VCAT myself.

One thing that VCAT did do was it actually made Melbourne Water tell me exactly what the charge was for. I actually argued quite strongly the charge was a tax and that's been defined by the High Court as a charge by a public authority for a public purpose that is compulsory and enforceable by law and my view that this

waterway charge actually met those criteria. VCAT didn't agree and found that I was liable for the charge. The examples of service that I received, according to VCAT, was that Melbourne Water had provided a living river stormwater grant - that's what I found out subsequently - to my local council to construct two concrete strips in a council-owned carpark about 36 kilometres away from my property. It's not even anywhere near a waterway that would ever go anywhere near my property. In fact the council carpark is actually nowhere near a waterway at all.

The council itself, had it not received that grant, could not have billed me directly for that work. I should also point out that it's only people in the southern part of the shire who pay the charge, so I would have thought people in the north would benefit as well. Also, Melbourne Water itself had received government grants in 2008 for stormwater projects. So here you have a 'service' that does not benefit a waterway or could not in any way benefit me which has been determined (*by VCAT*) not to be a charge related to public purposes or a charge from which I just generally benefit as a member of the community, but is apparently a direct service to me as a landowner 36 kilometres away.

As I said, I think this case raises enormous issues regarding customer protection and abuse of power. The other thing that I have noticed in correspondence between Melbourne Water and Essential Services, particularly in a letter in 2008, and also in other documents, I believe Melbourne Water was being required to phase out property based drainage charges in Melbourne in 2012 under COAG agreements which require user-based pricing. I actually note that these drainage charges in metropolitan Melbourne have themselves been renamed a waterways and drainage charge.

As I've said before, the metropolitan users now appear to be paying twice, both the parks charge and the waterways charge. What I noticed in the letter to the Essential Services Commission from Melbourne Water - and I've got a copy here for the commission - is that one option being proposed in 2008 (for the 2012 changes) is that an average charge of approximately \$476 replaces the property based charges. My concern is that if you then apply that average charge from 2005 to the additional 160,000 landowners that were brought into the metropolis in 2005, in effect Melbourne Water could increase its income by about \$76 million per annum through phasing out property-based charges in 2012. I believe that that is a concern. In summary, I believe that the legislative process engaged in the imposition of this charge and the lack of an effective review or dispute resolution system is extremely alarming from a competitive standpoint. I have therefore sought to bring this case study to the commission's attention.

**DR CRAIK:** Thanks very much. Forgive me if I got a little confused along the way.

**MS JOSEPH:** It's a very complex issue and, I mean, there's a lot of documents that have contradictory names for the charges and outline different services and actually weaving your way through it is quite complex, but basically it's a charge for the whole-of-catchment management that appears to have just materialised in 2008.

**DR CRAIK:** So what would your suggestions be for improving consumer protection? I mean, if consumer protection is clearly one of the issues that you raise, what would your suggestion be?

**MS JOSEPH:** I'd ensure that Melbourne Water and the water authorities are clearly covered and fall under the Fair Trading Act and the Trade Practices Act and also that there is an independent authority that has knowledge of water legislation that can actually be an arbiter and to watch over it. One of the issues with this charge is the legislation is horrendously complex. There's dozens of acts, incredibly long. So it's very, very hard to dispute it unless someone has very detailed knowledge of the legislation and virtually none of the authorities do. Then also as a member of the public you are up against a very large organisation who just says, "It's all okay, don't worry about it," and that's usually where it finishes. It has taken an enormous amount of work on my part and hundreds of thousands of pages of reading to actually to get to the bottom of it.

**DR CRAIK:** So are the water utilities, right now, not subject to the Fair Trade Act?

**MS JOSEPH:** That is what I was told by VCAT. I actually took an action initially in the Small Claims Tribunal, primarily because the application to the Small Claims Tribunal was about \$40 and it is a small claim, and I was told that while they may fall under the Fair Trade Act for water, they do not fall under the Fair Trade Act for a waterway service, because it is a service that they don't provide to me. That I was trying to dispute a charge for a service I didn't receive was the explanation VCAT gave me for refusing my application, but that, was exactly my point, because I was trying to say it was an unsolicited service or that it was misleading conduct.

**DR CRAIK:** And they are not subject to the TPA because they are a state corporation?

**MS JOSEPH:** What I was told by ACCC - and I don't know if it's actually correct - when Melbourne Water was brought under the Water Act in 2006 by the Water (Governance) Act, and the Melbourne Corporation Act was repealed, (the Melbourne Water Corporation Act specifically stated that Melbourne Water do not represent the Crown), the opinion of the ACCC is that when that happened Melbourne Water gained crown immunity from the Trade Practices Act, which I found difficult to believe, but I also find it quite concerning; that you have something that is supposedly a statutory authority that is now sending out retail bills to people and there is no way of really disputing them in terms of trade practices.



**DR CRAIK:** There's no dispute mechanism within the Melbourne Water structure?

**MS JOSEPH:** I went through Melbourne Water and made an application to Melbourne Water first. Basically all I got back was a statement saying, "Look at these sections of the act. It's legal and Melbourne Water gained catchment management authority by the order of November 2005." It is only when I went back to the order and discovered that it was a declaration under s.3 of the MMBW Act, which is largely a defunct section and that couldn't possibly have done what they said it did. The map that was created by Order in 2005 was then was incorporated into the Water Act by the Water (Governance) Act as Melbourne Water's area of operation. *(Although Parliament never saw or approved the map again the map was never published). However Melbourne Water contends that they derive their authority for the charge from the original order, not the late incorporation into the Water Act.*

It's not just fiddling around the boundaries, in fact it extended Melbourne Water's area to include Phillip Island, which must be about 80 kilometres in a straight line from Melbourne; right into the Macedon Ranges, which is a rural shire; Moorabool and Bass. So it was quite an extension and nobody was really told at the time that it had happened. I also argued quite heavily that that declaration was beyond the power of the Act and that as the map was never published there is also a case that it could have been ultra vires, but that wasn't accepted either. But I certainly met an enormous amount of resistance in trying to get anyone to look at it, and once you are talking about looking at the mechanism by which the charge has been imposed, that requires fairly in-depth understanding of the legislation and the process.

**DR CRAIK:** You went to the ombudsmen but that wasn't successful?

**MS JOSEPH:** I went to the Victorian Ombudsmen and they said that they couldn't do anything about it.

**DR CRAIK:** Why was that; did they explain why?

**MS JOSEPH:** I went both to the Victorian Ombudsman and the Energy and Water Ombudsmen Victoria. When I first went to the Energy and Water Ombudsmen Victoria they said that they couldn't do anything about it because it was outside their jurisdiction, so I pointed it out that it was within their jurisdiction. They didn't do anything for many, many months. When I applied to the civil list of VCAT they said they would look at it if I withdrew my application (which I refused to do). All they basically did was ask Melbourne Water the basis for the charge and got the same advice I had previously received. Then, when my application to the civil list was refused on the basis I have already explained, the Energy and Water Ombudsmen

informed me that as VCAT had already looked at it (which they hadn't), they couldn't look at it either.

Also I think the issue was that Energy and Water Ombudsmen couldn't really be an arbiter about the validity of the charge. There were a lot of things that have happened, in terms that there were also a number of documents at a government level that had been retrospectively changed in a number of cases, and in my view, the whole way in which the charge was imposed wasn't actually valid. That is a very complex issue to look at.

**DR CRAIK:** What would you think would be the best way to put some structure in place that would respond to those sorts of issues?

**MS JOSEPH:** I think, and what I have suggested in my submission is, there needs to be possibly a centralised system for setting up prices and for reviewing service-type charges, and also a dispute resolution service that is totally independent of state governments.

**DR CRAIK:** So you are suggesting a national?

**MS JOSEPH:** Some sort of national, where you have a body that is familiar with the legislation, familiar with representations that have been made about what the water legislation is, is familiar with COAG agreements on pricing and is therefore able to actually review this type of situation. Many of the people in my area, for example, my next-door neighbour has refused to pay the charge, because she is a 70-year-old pensioner and she wouldn't have been able to go through this sort of process. I am particularly persistent and have a bit more education than many and have been able to be read my way through all of this. But, failing that, it would be impossible to dispute it.

**DR CRAIK:** When you suggest a national system, are you talking about a national system for both reviewing price setting and service charging, just the service charging or the review mechanism, or what?

**MS JOSEPH:** I think there needs to be either a centralised review system and/or a centralised pricing system. My personal feeling is that the Essential Services Commission failed in this case. I would say that, because under the Water Industry Regulatory Order their only authority is setting a price for the metropolitan drainage charge. What they have told me, in an email they sent to me, is that this charge has nothing to do with metropolitan draining services and that in fact it is a charge, like a council rate, for a public good. If they have set the fee on that basis, they have acted outside their authority. Given that I knew nothing about my property being included in Melbourne Water's area until I received the bill, I had no opportunity to actually participate in the Essential Services Commission process.

I am also quite concerned by their correspondence with me, where they say that their function is not to protect the customer, it is not to determine whether or not charges should or should not be imposed on people, it is whether or not Melbourne Water can justify the cost of a service. Even then, the services and the costings that Melbourne Water presented at the ESC are not the same as the services that they presented at VCAT; what they presented to the Essential Services Commission was that this charge was for the provision of community grants or grants to private landowners, streamside management grant. So grants to private landowners for work on their own land, which I can't see would be a service to me, and the building of urban rain gardens in urban areas, which again I can't see why I would be liable to be charged.

The other thing I just want to make a point about, which I had forgotten to mention, is that my property is upstream of the Rosslynne Reservoir, which is owned by Southern Rural Water. In fact Southern Rural Water is responsible for creeks in my area, and the Port Phillip and Westernport Catchment Management Authority is responsible for the whole of catchment management. The water from my property would go into Rosslynne Reservoir and Southern Rural Water sells it; I don't impose a cost on anyone and in fact they should be paying me for the water. So the charge makes no logical sense and it has been an incredibly hard argument to put across.

**DR CRAIK:** No, it sounds like it is.

**MS JOSEPH:** Basically the end point is that Melbourne Water can send a bill to anyone they like, for whatever they like, and there is nothing anyone can do about it.

**DR CRAIK:** The challenge. Okay, I think we have got the gist of it; it is all about consumer protection, independent review, and a dispute resolution process.

**MS JOSEPH:** Absolutely, prevention of abuse of power and also the fact that this now provides a source of revenue to Melbourne Water that would not be available to, say, another entrant to the market. It is in effect a tax; they don't even have to justify the cost of the service they are providing or that I actually specifically received the service.

**DR CRAIK:** Thanks very much, Alison, thanks a lot.

**MS JOSEPH:** That's all right.

**DR CRAIK:** Okay. We're running a little bit early, but is Tony around?

**MR .....:** He's not here.

**DR CRAIK:** Isn't he? Okay, well, we'll have a 15 minute break while we wait.

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**DR CRAIK:** If I could ask both of you to state your name and position and then if you'd like to make a brief opening statement, I'd be happy to hear from you.

**MR KELLY (YVW):** Thank you, Wendy. My name is Tony Kelly, I'm managing director at Yarra Valley Water. This is Brett Mathieson, manager in charge of regulation. Yarra Valley Water is a retail utility operating in the eastern and northern suburbs of Melbourne. We service about 650,000 properties, a population of about one and a half million. We buy our bulk water from Melbourne Water and we pay Melbourne Water to treat the majority of sewage, although more recently we're embracing a lot of decentralised systems where we're actually controlling the sewerage treatment process as well to facilitate recycling.

Some points that we'd like to make: I guess we understand that water plays an important role in the overall economy of Australia and that the water utilities and the water industry generally have a responsibility to play its role in supporting the economic growth of Australia and also I understand too that water and sewerage services are absolutely essential and that safe drinking water and effective sanitation underpin standards of living and also the health of the community. Water engineers love to say that they've saved more lives than doctors through the provision of clean water and sanitation services.

Yarra Valley Water are pro reform. We do see there is a lot more opportunity for further reform in the water industry. We have been on a journey for the last 20 years of continuous reform and we see that continuing into the future. There have been a number of really good things achieved in Victoria, we believe. We've got pretty effective planning processes, the processes that were - the last one we were part of was the central region sustainable water strategy which included Melbourne and its neighbours and those plans have been rolled out over the whole of Victoria and they're very comprehensive. They include major input from the communities affected and they take a very long-term perspective and also have short-term plans associated with them as well, so we think that is a very effective framework.

We like, here in Melbourne, the separation of wholesale and retail very much. We see its focused accountabilities. We're much closer to our customers than most utilities are being just a retailer and I think that has delivered major benefits. On top of that we have a corporatised structure which again has provided quite a commercial discipline to the organisation and strong governance and allied with that is an operating licence - or a statement of obligations it is now referred to - which defines what we do and how we do it and our responsibilities to our customers and to the environment generally.

Independent price setting through the Essential Services Commission in Victoria we see as a major plus and a great discipline on the water utilities to produce sound, long-term plans. The other thing we like about Melbourne in particular in

the comparative competition. We feel that has delivered major benefits for Melbourne customers and for our shareholder, the state government. We also like very much the fact that we have actually allocated environmental entitlements to rivers in Victoria. Whilst they have been compromised during the drought, I think in the future they will deliver major benefits, in an ecological sense, back to the Victorian environment.

The reform agenda, moving forward, we do believe there is more required. We're pro competition. We've seen the comparative competition work and we see there's opportunities for the introduction of more competition. We hear the economic dogma coming from a lot of economists around, "Why don't we just separate out the retail from the distribution?" We feel the jury is still out in that regard, particularly in energy. We don't think the benefits are as great as is claimed. The other issue for us - we are a community energy model, we are a combined distributor retailer. If you look at the levels of service that are delivered to our customers, then the vast majority reported by the Essential Services Commission are driven by the distribution function and if you take the distribution function out of retail, then the retail effectively loses control over the levels of service delivered to its customers. Plus the margins in the retail end of the business are very small.

So our approach to competition is that we would like to see more competition, but we would like to introduce it firstly at the wholesale end. 56 per cent of Yarra Valley Water's costs are bulk water and we have virtually no choice in that regard, whereas we know there are cheaper sources of water available and we would like to see the competition introduced at that end of the system. Allied with that would be autonomous bulk water entitlements whereby utilities south of the divide would get an autonomous entitlement which could be used to transfer water around the state to where the needs are greatest. That already happens in northern Victoria, it doesn't happen in the south at this stage.

The other thing allied with autonomous bulk water entitlements and more competition is we see the establishment of a state water grid. We have been pushing that very hard. We see lots of opportunities come with that. To make all of that work and to establish the ground rules on how water is transferred around the state, we do see that it's important to establish a water grid manager, not unlike VENCORP, which existed in the gas industry prior to that going national. We see a state water-grid manager doing a lot of the statewide planning, to establish rules for the movement of water around the state, establish levels of security, flag augmentation needs over the longer term, predict demand for water and sewage services, monitor environment flows and recommend levels of restrictions; but taking an overall statewide view rather than a parochial view of each utility, which is never going to optimise the overall result.

Pricing in water is definitely complicated by issues of equity. We can't have a

discussion about water without people saying, "Does that mean people in Toorak can buy their way out of restrictions?" For some reason, water is seen as different from other products. No-one seems to worry that people in Toorak can buy big V12 cars and use as much petrol as they like, but water, for some reason, seems to be different, even to the extent where Yarra Valley Water makes front-page headlines in *The Age* in Grand Final week, when we canvass some pretty innocent options on tariffs, moving forward. So there's a measure there of the complication that comes with water pricing I think.

Canberra have a pretty much a one-size-fits-all pricing regime, and we'd like to move to something different. But in moving to something different, there's always going to be winners and losers. That has been the pattern over the last 25 years in Melbourne, as we have gradually moved to more user-pays, and any further moves need to be managed in a gradual way, to manage the impacts on the winners and the losers in particular. There's a lot of discussion about scarcity pricing around at the moment. I think it's a very simplistic view of the world, I don't think it's politically palatable; and, given that the water industry is owned by governments around the country, I think we need to be careful about what that means. For instance, if we changed the distribution costs between tenants and landlords, then there'll be winners and losers in that.

The last point I want to talk about is this issue about decentralised versus centralised infrastructure, that's also a major debate in the industry, and also cities of the future or integrated water management seem to be catchcries at the moment. We have done a lot of work in that regard at Yarra Valley Water, we have done a lot of analysis, and the a conclusion we have come to is there certainly isn't a one-size-fits-all, that what works in one area will not work in another area, and that's not just physical constraints but by looking at environmental impacts. So having blanket rules that you see in a lot of jurisdictions - you know, how every home should have this facility or that facility, a rainwater tank for example - doesn't stack up when you look at a sophisticated environmental analysis which is trying to look at alternatives on the overall impacts on the environment.

We are pro-decentralised when we have the opportunity. The northern suburbs in particular present a great opportunity for us. We have to pump the water three times to get it to the northern suburbs, and three times to get it back into the centralised systems. So having local recycling in that region makes not only economic sense but a lot of environmental sense. We have got a number of case studies where we are delivering innovative projects, which include recycling of stormwater and treated sewage as well back into homes through what is termed a third pipe, for garden watering, etcetera.

We have also got a couple of other innovative proposals at Kinglake West, Doncaster Hill and Coburg, which is a combination of 100 per cent decentralised,

self-contained and using the integration of stormwater with sewage. A critical factor in all of that is valuing externalities. We have taken the onus to compute what they will be and we are also at the moment bearing the cost associated with those externalities, believing we have community support for that. In the longer term that needs to be much more transparent, and the key issue is who should pay for those externalities.

Just to sum up, I don't think there's any silver bullets to reform. I think inter-basin planning is critical; more competition is important; mechanisms to allow inter-basin transfers is very important, it would be great to bridge the city-country divide - it seems the feeling is that only one can win at the expense of the other, and that's a great shame; the pricing of tariffs - managing winners and losers is important and you have to take a long-term perspective; and finally, valuing externalities is critical to getting alternative infrastructures up and running.

**DR CRAIK:** Great. Thanks very much. Under more a security framework, you've mentioned that you have to publish a five-year outlook to determine whether five years of water security can be guaranteed or if some other long-term options need to be pursued. Once you've decided there's a need for augmentation, what is the process for actually investigating and choosing the next supply augmentation and who actually makes the ultimate decision?

**MR KELLY (YVW):** The planning is comprehensive, so we look at a range of options. We would make assessments of all those options both on a net present value and an environment impact. Then you've got to look at what is socially, and even politically, acceptable and put all that together, to come up with what ends up being a negotiated solution amongst the key stakeholders.

**DR CRAIK:** Including the government, do you say?

**MR KELLY (YVW):** Well, including the government, including the consumers, including other utilities that have to partner in the development of the new options.

**DR CRAIK:** Are all of the options put on the table and are they transparent? Is there transparent, publicly available information on the range of options or - - -

**MR KELLY (YVW):** It's well known that there are some policy bans around the country. Various governments have published that they won't do certain things, or they have a preference for doing other things, and it's within that context that we have to manage the industry.

**DR CRAIK:** So is it the Yarra Valley Water board that ultimately makes the decision or does it really ultimately sit with the government?



**MR KELLY (YVW):** It depends. If it's a local issue, so if I look at the Hume Corridor in the northern suburbs, that I talked about before, we would make our own analysis about what is best for that area, in consultation with the developers, the council and any other key stakeholders in that area, and then our board would endorse a servicing strategy for that area. When it comes to looking at metropolitan-wide systems and major augmentations, then clearly it's a much broader stakeholder group.

So we would work closely with City West Water, South East Water, Melbourne Water of course, Western Water. Anybody that's connected to the Melbourne system and shares our resources would be involved in that discussion; as well as the Department of Sustainability and Environment, who have been driving these regional sustainable water plans. I have to say that they have done a brilliant job in that regard. They are very complex documents, but I think they're very sound documents.

**DR CRAIK:** Thanks. In terms of the overarching objectives and principles for the metropolitan demand strategy - you list them down in your submission, and there's a number of them - some of them seem to be almost conflicting. So how do you actually decide on trade-offs between those objectives?

**MR KELLY (YVW):** Dealing with conflicting objectives is core business for a water utility. We're owned by governments, so we inevitably share the conflicting objectives that governments have. You could say they're conflicting or that they're issues to balance. So we have to balance the social needs against the cost of these projects against the environmental impacts, and the industry has developed a number of models in that regard: the Water Services Association of Australia, a peak body, has developed a multi-criteria analysis; there are least cost solutions models around, there's any number of models that are being used around the country.

None of them are perfect, and all of them have some elements of subjectivity in them, because the science isn't concrete. Particularly on the social side it's difficult. It's opinion based. When you're running a monopoly and your customers don't have a choice, it's impossible to get a unanimous view. So you have to tread a difficult course I think to balance those three elements and be accountable for the final decisions that are made in the end.

**DR CRAIK:** Do you think it these multiple objectives distract water utilities from what you might describe as the main game?

**MR KELLY (YVW):** Well, what is the main game? I think most utilities have a genuine interest in looking after the environment. Most people work in the water industry, not because it's well paid because despite what you see in the press I don't think people in the water industry are particularly well paid, but they work in the

industry because they like what we do and how we do it. We attract people with a strong social and green conscience and we see environment as core business at Yarra Valley Water. We have the environment at the same level as customers and we try to make sure that we're not trading them off, but delivering great customer service at the same time as delivering good environmental outcomes.

It's something we've grown up with. It's always been the case in the water industry. We've had some notable failures in our business where we have employed people from private industry who have a more one-dimensional view of the world and, to be frank, they have often struggled to deal with a triple bottom-line approach. But I think the water industry deals with it reasonably well.

**DR CRAIK:** Okay. You mentioned this community costing framework in your submission that does take account of the cost of externalities and things. So can give you an example of what sort of externalities are accounted for and how do you put monetary on those externalities.

**MR KELLY (YVW):** So all the work that we've done on the environment - and we use life cycle assessment which is the only sound scientific tool that we're aware of to compare the environmental impacts of different projects. When we have used that tool and we have used it extensively, there are three things that always come up the top and the rest are almost immaterial in terms of environmental impacts. The three items are: the amount of water extracted from rivers; the amount of greenhouse gas that we produce and the amount of nutrients that we discharge. They are the three dominant factors that affect any water project.

So when we're looking at, say, a Doncaster Hill proposal where we plan to provide recycled water into multistorey developments, we looked at servicing that in a traditional way which would be just connecting it to the centralised infrastructure or we looked at it alternatively as collecting the stormwater and the sewage from that development, cleaning it up and then recycling it back into that development. In doing that, if we look at the greenhouse gas impacts, we determined that the greenhouse production from that system is lower than the equivalent from a desal plant, for instance. If you look at the nutrient loads, we use a surrogate there, which is the Melbourne Water pricing for nutrients. Melbourne Water charges new developers an amount for new development based on the amount of nutrients discharged by that new development, so we use that as the benchmark number and it gives us a material value for the nutrients. So if we're saving 500 kilograms so we can quite easily attach a monetary value to it.

That is how we do it. We have subjected that model to independent scrutiny. Frontier Economics have done some work on behalf of DSE looking at that model. We don't claim that it's perfect, Wendy, but we've had a red hot go at it and we're keen to hear from anybody that can help us improve that model. What we're finding

is that as soon as you include a value of externalities, you come up with alternative solutions almost immediately which are quite often very different from the traditional approach from water utilities. The question, as I mentioned before is, "Okay, given that, who should pay for the lesser volume of nutrients now discharged to Port Phillip Bay? Should it be Yarra Valley Water customers, should it be the general community, should it be the government or should it be - - -"

**DR CRAIK:** Should there be a CSO or should there be - - -

**MR KELLY (YVW):** Should it be an explicit CSO? Yes, that would make it even more transparent and would provide quite a discipline back on utilities as well which we would welcome. But in the absence of all of that - - -

**DR CRAIK:** It's shared across the customer base, is it?

**MR KELLY (YVW):** Yes. At the moment these costs are not material in the scheme of things but they will become more material as they become more common.

**DR CRAIK:** That's really interesting, thanks. Moving on to pricing and some of the comments you made about that and the commentary and the response about the suggestion of offering a range of offerings, as it were, to customers, clearly you're considering and think they're worthy of pursuing. Do you have views about what sorts of offerings, like, whether you would be selling security or you would be selling green water? Do you have views about those sorts of things?

**MR KELLY (YVW):** I don't think we have a view. We have a number of options that we would like to canvass with our customers and any one of those are valid views. We get a lot of complaints from customers, particularly households with a small number of people. So a retired couple or a single person complain a great deal about the fact that the fixed charges are so high and that when they do save water, as we have been asking them to do through the conservation program, they're not seeing a material benefit in their bill. So there is a lot of pressure on us to change the mix of fixed and variable charges. Our current regime works much better for larger households. So that is one obvious area.

The potential to offer customers a tariff option which provides a high level of security, I guess, is an obvious thing to do but whether that will get any legs in the end is another issue. It raises another question as well for us which is the jurisdiction of the Essential Services Commission on actually setting tariffs and I think there is one argument and I think it happens in the UK where the regulator sets a revenue requirement - the cap, if you like - that a utility is entitled to a certain amount of revenue. Then it's up to the utilities to define how that really is derived from its customer base in consultation with its customer base.

At the moment it doesn't look like we have that discretion, so we would have to convince the ESC of a certain tariff structure and that might be a good discipline in the short term and in the longer term I think we would like to move to something different.

**DR CRAIK:** Something where you have more control over it.

**MR KELLY (YVW):** I think so and be more accountable for the outcomes associated with it.

**DR CRAIK:** Have you surveyed your customer base on those sorts of issues?

**MR KELLY (YVW):** Not in any depth yet, but we will over the next 12 months.

**DR CRAIK:** Okay. If that information is available and it's possible that we could get a look at it before we finish our report, even if it's preliminary, we would be interested in that. In your submission you note that customers expect equity in the deliver of water and sewage, including the issues of common tariffs, and certainly it's something we're encountering everywhere that people would rather share the pain of restrictions than see other people pay to not have to live with restrictions. How do you balance that up against the notion of the customer choice issue? It seems it is a very difficult issue because there is such strong community support for restrictions.

**MR KELLY (YVW):** It is very difficult. This whole issue of equity, as I said, really complicates water pricing.

**DR CRAIK:** Water seems to be different.

**MR KELLY (YVW):** It seems to be unique in water.

**DR CRAIK:** That's right.

**MR KELLY (YVW):** We're not quite sure why that is the case. Water is different in one sense because people ingest it, I guess, and it's very important to - - -

**DR CRAIK:** People ingest bananas and when there was a shortage of bananas, they weren't restricted.

**MR KELLY (YVW):** Fair enough. But you'd probably rather have Australian bananas than South American bananas. It is problematic but we feel like we have onus to at least engage with our customers and have the discussion and inform the debate, if you like, moving forward.

**MR MATHIESON (YVW):** I think in theory if you captured that value that a

certain customer group was willing to pay for greater security then, given our revenue requirement is still the same, the rest of the customer base get the benefit in terms of lower price than these people. So whether that it still palatable to the rest of the customer base, whether it's saleable is a question. In the reverse, one of the issues, why do we impose restrictions? We basically impose restrictions to give us time either for it to rain again or to build the next augmentation. So the same thing, if you've got a group of customers who actually are quite willing to restrict their usage earlier than the general customer base, they would get the benefit up-front but in the end, the standard customer in the middle gets the benefit of these people restricting their use earlier than everybody else.

In theory it works but in practice that's where the issues lies. That's what we will explore with our customers and see whether there is any tractions as well as stakeholders.

**DR CRAIK:** It will be very interesting to see how that turns out. It is quite fascinating. You made some commentary on scarcity pricing in demand management. Do you think it has any role at all, scarcity pricing in demand management? Do you think price has an effect, I suppose?

**MR KELLY (YVW):** It seems that it's an easy place for your average economist to go to, because that's the way that every other product in the marketplace is managed. I think water is different because it is unavoidably political and I think that prices can go up and down at relatively short notice without having a pretty thorough understanding of the impacts on various customer segments. They're just not optimistic about that happening in the short term. I think we've got so many other things to do that that seems to be pretty low down the list of my priorities. Brett?

**MR MATHIESON (YVW):** Look, I think that if you look at how much the customers have saved under water restrictions and water conservation, it's 40 per cent. So, depending on your elasticity, you're really going to say that prices are going to go up 200 to 400 per cent to capture that same level of savings. It's a very difficult thing to put forward to customers, I would think.

**DR CRAIK:** Do you think now it's even more difficult, given the reductions people have made in their usage, that the elasticity is probably even less than it was?

**MR MATHIESON (YVW):** That's right, yes.

**MR KELLY (YVW):** We know, Wendy, that a lot of households and businesses have hardwired water conservation to their homes through water-efficient appliances so the discretion we have moving forward or the elasticity moving forward is certainly hardening. There's no doubt about that.

**DR CRAIK:** When restrictions are put in place, do you guys make the decisions about restrictions?

**MR KELLY (YVW):** We monitor the situation very, very closely. We do all the sort of background technical work, if you like. We will make recommendations and the final outcome will be something of a negotiation between the parties involved.

**DR CRAIK:** The parties being?

**MR KELLY (YVW):** The utilities. The retailers have primary responsibility in that regard, but we definitely include Melbourne Water in every step of the way and then of course there's the role of the government departments, who have a vested interest. They oversee the whole of Victoria. They're interested in relativities and how what might happen in Melbourne might potentially affect other parts of the state, et cetera. So understandably there's a number of players getting involved in final decisions.

**DR CRAIK:** So, at the end of the day, for your customers, do you announce a decision or does someone else announce it?

**MR KELLY (YVW):** In Victoria the pattern has been that the government makes the announcements.

**DR CRAIK:** And it's the same right across all three retailers?

**MR KELLY (YVW):** Yes.

**DR CRAIK:** Do you cost the effect of those restrictions?

**MR KELLY (YVW):** We have undertaken studies to determine the cost of restrictions, but what we haven't done is - I mean, quite often what happens is if you have to move to a more severe level of restriction, it becomes a security issue as much as anything. That's fundamentally one of the key issues for the water industry. We have to deal with the vagaries of the weather. You know, in 2006 we were accused of not planning and not being prepared for what happened in 2006, but I can guarantee you that if we had proposed to build a desal plant in 2005 we would have been laughed out of town. So it is very difficult. So one of the things that we are dealing with all of the time is risk and making judgments about a risk is very difficult.

We have a very close relationship with the Bureau of Meteorology, but, as everyone in this room knows, it's hard enough to predict the weather next Sunday, never mind what it's going to be next spring. But somebody has to stand up and make a call in that regard. It seems that no matter what decision is made, that there's

always a segment of the community that's not happy, and that's to be expected, but we have to make the tough decisions when we believe they're required.

**DR CRAIK:** Do you use a kind of options based approach to planning?

**MR KELLY (YVW):** Yes.

**DR CRAIK:** In terms of coming through this last water shortage period, did you use voluntary targets? I assume you used information campaigns a lot, sort of moral suasion. Do you think they were very effective ways of - - -

**MR KELLY (YVW):** I think one thing we did learn when we had the process was that voluntary targets can be very effective. So here in Melbourne we ran the Target 155 campaign, which was encouraging individuals to not use more than 155 litres per person per day. That was very effective. When we first introduced that, we introduced it as a means of avoiding more severe restrictions. The theory behind it was that we would give our customers choice around how they would save water, rather than be too dictatorial about what they could and couldn't do. Sure there was still a level of restriction there, but the call to save water under the 155 campaign was very effective in enabling us to avoid going to more severe restrictions. The community embraced it with some enthusiasm, we'd have to say.

We had virtually no criticism and a lot of media support. Either the media was passive or it was supportive. The community, I think, recognises that there was a serious problem. They may have thought that the water industry hadn't planned well enough, but, by the same token, I think the community had also attached climate change to the lack of water, so it wasn't as if the water industry on its own was responsible. So there was this whole ground swell out there about people who understood the link between a shortage of water and climate change and that they all needed to do something together to help get through this situation.

What also made that effective, I think, was that we did have augmentation plans behind all of that. So we said to our community, "We want you to save more water, but the light at the end of the tunnel is we'll have these new supplies online in a couple of years or three years," whatever the case was. "If you could just work with us over this next couple of years, these supplies will be online and then we'll be able to ease restrictions." That was, in my mind, an implied deal with the community. "You save, give us a bit more time, we'll deliver the augmentations and then we can lift the restrictions."

**DR CRAIK:** So are there no restrictions now and do you believe there shouldn't be restrictions with the desal plant into the foreseeable future?

**MR KELLY (YVW):** There's been a big debate in the water industry here in

Melbourne about whether we should have restrictions moving forward. There's some elements saying we should never have restrictions. That poses quite a discipline on the industry to maintain levels of supply. The difficulty with that will be that we will be augmenting supply before it's obviously needed, in advance of a future problem which is difficult to predict the timing of. So in that case we'll be accused of gold plating. So we get accused either of gold plating or lack of planning. The pendulum never seems to stop in the middle. So I think we're seeing restrictions at the moment as a last resort. In the last 10 years, we've seen restrictions as a big tool in our toolkit, if you like. We're feeling that the community wants to see it as a lower priority, so in the future it is more of a last resort, rather than a first resort.

**DR CRAIK:** You've talked about the comparative competition and the benefits of comparative competition between the Melbourne retailers. Do you think you've reached the limit of the benefits from that comparative competition? Do you think the big gains have been made and now it's - - -

**MR KELLY (YVW):** I think there's some element of truth in that, Wendy. I think the comparative competition regime has been very effective. I guess it suits me because everyone tells me I'm a pretty competitive person. There's hardly a day goes by that I don't wonder what Anne Barker or Shaun Cox is doing in their businesses.

**DR CRAIK:** You can ask Anne. She's just here.

**MR KELLY (YVW):** I think that's very productive. That's good for our customers and good for our shareholders and it has worked very well in that regard. I think it's running out of steam a little bit and we've made that case very strongly to the Essential Services Commission. We would like to see a new suite of key performance indicators used in the league table to revitalise the industry. We would like to see the reintroduction of a section in the comparative report on innovations that encourage utilities to innovate more, and the ESC acknowledge that. We see that as another spur for improvement. So it's worked pretty well, but we can do more with it.

**DR CRAIK:** As I understand it, you share entitlements to bulk water between the three of you.

**MR KELLY (YVW):** Yes.

**DR CRAIK:** Would you like to see having your own bulk entitlements so you are free to do what you like with your own bulk entitlements?

**MR KELLY (YVW):** Very much so. I think the current pooled entitlements were also seen in a policy sense as an interim measure. Originally they were ostensibly owned by Melbourne Water, but they were officially assigned to the retailers a few



years ago and they were purposely pooled. The intention then was that they would be pooled and we would jointly manage that resource and over time the rules would be put in place to enable us to autonomously manage our own entitlements. It is complicated a little bit because we share the same system; the wholesale system in particular. But with the establishment of a state water grid the possibility of introducing more wholesalers into Melbourne and us managing our entitlements autonomously presents itself. Gavin Hanlon would manage his own entitlements autonomously and I think he would be horrified with the prospect of pooling his entitlements with his neighbouring utilities and having to manage them jointly, because my experience with that is that you always get lowest common denominator outcomes.

**DR CRAIK:** Will you get entitlements to the desalination water and the Goulburn Pipe water?

**MR KELLY (YVW):** I have an expectation that will be the case.

**DR CRAIK:** But you don't have them at the moment?

**MR KELLY (YVW):** We do have in the North-South Pipeline?

**DR CRAIK:** Do you?

**MR KELLY (YVW):** Yes, in the Goulburn Valley.

**DR CRAIK:** Third-party access, we understand Victoria is thinking about third-party access. Do you think it will lead to consumer benefits, price reductions and things?

**MR KELLY (YVW):** It is hard to promote more competition of the wholesale-end of the system without also saying you have got to allow third-party access, so we are supporting the introduction of third-party access on a staged basis. I think it is unlikely to have a material impact on the majority of people in Melbourne, but it will be a major spur for utilities, in terms of them coming under more competitive pressure. I say to my people: if someone can come into my patch and provide water services better or cheaper than we can, there is something wrong with us. So I think it will be another spur for innovation and general improvement. It is hard to imagine at the moment that it is going to have a major impact on supplies. I think in Sydney it certainly hasn't done that.

**DR CRAIK:** That's right.

**MR KELLY (YVW):** But it is nice to have that threat in the system, I think.

**DR CRAIK:** Okay. Do you think comparative competition is something that should be picked up by other states.

**MR KELLY (YVW):** Absolutely. If you look around the country, most of the utilities are vertically integrated. In Melbourne it is obviously not the case, but it creates a very different dynamic. For instance, we have a major incentive to chase unaccounted water because we are paying a high wholesale price for water. When I was in the former Melbourne Water, which was vertically integrated, that wasn't even on anybody's radar because all that was contained inside the organisation. If I look around the country, very few utilities are subjected to any competitive pressure of any sort, and while comparative competition is a pretty weak form of competition, at least it is a form of competition. Professionally it has worked very well on the water industry in Melbourne as a spur for improving. None of us want to be last on the essential services league table. Professional pride ensures that you do deliver improvements.

**DR CRAIK:** I guess it will occur in South East Queensland with the three retailers, I suppose there is a possibility there.

**MR KELLY (YVW):** We expect so. They have an ideal opportunity to do exactly that.

**DR CRAIK:** Geography will be important. We were discussing this with Sydney Water yesterday and they said that would be more difficult there because of the interconnected nature of the distribution system; the spiderweb-like nature of the distribution system.

**MR KELLY (YVW):** That's the same in Melbourne; the wholesale system in Melbourne sits over the top of Melbourne like a spider's web, if you like, and the retail infrastructure sits underneath it. We have contact points between the two, and at each of those points we have a level of service which is defined in a Bulk Supply Agreement. So I think that is all entirely achievable. I can remember being in the former Melbourne Water, going through the debate about how we would spread wholesale and retail, and you can find 500 reasons why you wouldn't do that, but our experience in Melbourne, and my personal experience in Melbourne, is that it has been very beneficial and it is entirely achievable.

**DR CRAIK:** Thanks. In your submission you refer to the shareholder executive in the United Kingdom, the Crown Company Monitoring Advisory Unit in New Zealand, can you indicate why you think they are good examples of oversight of government business enterprise?

**MR KELLY (YVW):** I think, generally, around the globe, governments struggle a little bit to be effective shareholders. It is not something that the bureaucracy is used

to by any means and the models that we have quoted in our report there I think provide an alternative way of managing GBEs, at arm's length from government, but with probably a greater discipline than government have time to exercise. So, yes, we are supportive of a body of that ilk managing the governance around GBEs.

**DR CRAIK:** One final question, do you think the notion of an independent procurement entity, as the ERA in WA has suggested, is a good idea or would add value in Victoria or generally?

**MR KELLY (YVW):** Might I explain what I think that is, so we are on the same wavelength. I think that is like an independent body, almost, from the utility, which is charged with the responsibility of delivering new augmentations to - - -

**DR CRAIK:** That's right, supply augmentation, and it can extend to looking at the whole supply/demand issues and down to things like pricing and restrictions.

**MR KELLY (YVW):** I think I would not support that, and you are probably not surprised to hear me say that. But what that would do is just take a lot of the responsibility away from the utilities, who have direct contact with customers, giving it to a third-party that probably has very little contact with customers. What does that turn the utility into? It turns it into just an operating machine, which would be a far less attractive place to work and it would be more difficult to attract good staff. The responsibilities would be so dramatically different it would change the whole nature of the utility. So I would be very concerned about the prospect of establishing an entity like that in Melbourne.

**DR CRAIK:** Okay. Thank you. I think that ends my questions right on time, fortuitously. So thank you very much, and thank you for your submission, which is full of very useful information. Thanks Tony, Thanks Brett. Now we will have a break for lunch and we will resume at 1.30 for the Consumer Utilities Advocacy Centre.

(Luncheon adjournment)

**DR CRAIK:** Okay, we will now resume. Jo, could I ask you two to identify yourselves and your position for the record, and then if you would like to make a brief opening statement, we are happy to hear it.

**MS BENVENUTI (CUAC):** Thank you, commissioner. My name is Jo Benvenuti, I am the Executive Officer of the Consumer Utilities Advocacy Centre. Caitlin?

**MS WHITEMAN (CUAC):** I am Caitlin Whiteman, I am a policy advocate at the same organisation.

**MS BENVENUTI (CUAC):** We would like to thank you for the opportunity of presenting to the hearings and to represent consumers' interests in this process. My initial opening comments are to do with consumer focus. We believe that consumers have been left out of past urban water reform policy development and implementation processes and that this has led to a neglect of consumer interests. Following the UN consumer guidelines described in our submission, we believe that consumers have the right to be heard, to have their interests represented in water policy making and execution, and in the development of water services.

We realise that discussing water issues in relation to the term "rights" is often considered by some to be outdated and irrelevant, but we believe that it is very important to keep these fundamental values in mind. A strong, principled position here does not preclude serious consideration of the economic and other dimensions of urban water. We note that the Productivity Commission's process and issues paper has given greater consideration to consumers and their interests than we often see in policy making and regulatory processes and we hope that this is carried through to the commission's final report and to its recommendations.

We have put a submission to the commission. Our submission covers a number of issues, but we would like to talk to a few of those that we see as most important. The first area that we want to cover is supply augmentation and decision making. In our submission we suggested that supply augmentation, planning, and decision making hasn't been particularly well done in Victoria in recent years. You have heard similar arguments in a number of other submissions to this inquiry. You would also be aware of the Victorian Auditor General's report in 2008 on planning for water infrastructure in Victoria, which found that the 4.9 billion Victorian Water Plan was developed quickly and with varying and sometimes inadequate regard to on-going project costs, benefits, and risks. You have also heard from advocates of scarcity pricing or dynamically-efficient pricing that the only efficient way to augment supply is to have the volumetric price of water changing flexibly. CUAC believes that supply augmentation decisions can be improved by less radical means; namely, greater involvement from consumers and communities.

I will return to the Auditor General's report on water infrastructure planning.

Importantly, from CUAC's perspective, it also highlighted a number of deficiencies in regard to community engagement, including, on the finalisation of the Water Plan, that it had minimal stakeholder consultation. In that report it stated that the level of information provided to the community on water supply projects was inadequate and needed to be improved, with the rigorous project estimates and information about the processes used to select and prioritise water supply projects needing to be made publicly available. The audit also considered the institutional and funding arrangements for the sector and whether this supported appropriate planning. They found that the institutional arrangements were not a barrier to appropriate selection and prioritisation, but that things had been done in a rushed and unsuitable manner.

Similarly, we have also seen in relation to the desalination plant that full information about the costs was not made available to the public for people to scrutinise. Water supply projects are typically huge investments and therefore a very high level and standard of public and consumer consultation and engagement is warranted. Ultimately consumers bear the price of this infrastructure in their water bills. We believe that greater involvement of consumers and communities, for example, through the kind of deliberative processes outlined by Dr Stuart White, director at the Institute for Sustainable Futures, would greatly improve supply augmentation and decision making. My colleague Caitlin is going to cover the next section of our report to you.

**DR CRAIK:** Thanks.

**MS WHITEMAN (CUAC):** Yes, the other thing we wanted to talk about is pricing; in particular, scarcity pricing, which we note has been receiving a lot of attention lately from policy makers. It is a fairly new concept and one that we, as consumer advocates, haven't had a great deal of time to work through, so at CUAC we wouldn't pretend to have done sufficient work in working through all of the issues there. Pricing of urban water is a major part of our upcoming work program. We are going to be holding a forum on consumers and urban water pricing in February next year, so we are going to look at these issues in more detail and hopefully try to build the capacity of the consumer sector to talk about these issues.

Having said that, we do have preliminary comments and some concerns about these pricing reforms. Firstly, as we have noted in our submission, we do have concerns about the distributional impacts of scarcity pricing. People on lower incomes are going to be more responsive to price signals - I think that is well established - and this needs to be borne in mind when we are thinking about how we design tariffs. Willingness to pay is a concept that we often see talked about here, but it is often not acknowledged that capacity to pay is a part of what makes up willingness to pay. I am happy to see that you have noted that in your issues paper, which is great. Those issues need to be taken account of. We have also talked in our submission about the idea of 'highest value use'. We think that is a useful concept,

but it really needs to be used with caution and care when we are talking about urban water and essential service. We need to remember that highest value, in an economic sense, might not be a sufficient conceptual framework for thinking about our social objectives in water as well.

Secondly, we think there has been insufficient attention paid to the equity and social impacts of scarcity pricing, and there is a real need to talk about that in a lot more detail that we have seen. I note that Quentin Grafton, as a prime advocate of scarcity pricing, has argued that it is both efficient, because it delivers the lowest average volumetric price over time, and equitable. Then he says, "If coupled with reduced fixed fees and with greater assistance to lower-income households," he suggests," the excess revenue raised at some times can then be used in a progressive way to compensate households."

We think that advocates of scarcity pricing really need to engage with this issue more thoroughly rather than as a kind of afterthought or one sentence in a paper. People in the community sector who work with low-income clients know the concessions and assistance programs, we know them more intimately and we know some of the problems that can occur with them and that it can't simply be assumed that all these equity issues will be dealt with down the track.

In Victoria for example we currently have a water and sewerage concession for eligible customers which provides a 50 per cent discount, which is capped at I think \$245 per year. At present that is probably a fairly good concession; it's probably sufficient, we would say. Most people are receiving a concession that doesn't reach that cap. However, if prices rise substantially the cap will become largely a notional kind of figure. We know that advocating for a bigger budget for concessions is actually quite a difficult thing to do, and it can't just be assumed that these assistance programs will rise to take account of rising prices.

There's no guarantee that excess revenue would be returned in a progressive way to households and that just can't be assumed. So we think that any major urban water pricing reforms have to integrate identification of customer impacts - for example, through modelling studies, through engagement with community sector workers like financial counsellors that work with low-income customers to look at what the impacts would be and to design assistance measures. That needs to be done in a whole-of-government way where we integrate looking at those issues at the beginning of the reform process.

We are also concerned just generally that there is a shift to look at the whole water sector through the lens of pricing or to try and make water decisions through pricing without the community being involved very much in this or having a say about whether that's how they want to manage Australia's urban water.

**MS BENVENUTI (CUAC):** In conclusion, we wanted to raise that, because of the impact of drought and restrictions and the amount of community education that has accompanied those, consumers are very engaged and invested in water issues. Community members have largely voluntarily reduced consumption and changed attitudes to water use, in addition to a restriction environment. We are very concerned that in transitioning to new pricing and new supply arrangements there is a danger of losing this community goodwill, understanding and investment.

We think that government policy and vision around this needs to be articulated and understood in order to get community engagement with a reviewed vision of how that might work. So the community needs the opportunity to engage in water supply and pricing decisions and to have the opportunity to have a say in where they stand on, say, restrictions versus price or demand management. That brings to an end our formal comments to you.

**DR CRAIK:** Thanks very much, and thank you for your detailed submission. We're interested in your submission. You have raised the issue of water being an essential service, or an essential right. Do you have a view about what is a minimal acceptable or essential level of access to water, because you do say "a level of water use beyond that needed to meet basic survival needs is necessary to social participation and inclusion"? What sort of uses are you talking about? Also, do you have a volumetric view of it?

**MS BENVENUTI (CUAC):** It's a really difficult thing to come to, and we think that policy-makers would have as difficult an exercise in going to this as we do. That's because of the variety of house sizes, the characteristics of those households, their health and welfare situations, which are all individual. In terms of Victoria, we have been set various targets; the 155 target as something that's appropriate. The other thing that we would argue is that in order to participate in society you need to be able to have more than just very basic essential use, and that that promotes social wellbeing and health and welfare outcomes.

**MS WHITEMAN (CUAC):** And social cohesion as well. We don't want a society where entire groups of people can't, say, have a modest garden. But in terms of putting a volume on it, that certainly is not something we can do at this point.

**DR CRAIK:** Do you have any view about whether it's around the 155 limit? I mean, is that sufficient? Do you have a view about that sort of thing?

**MS BENVENUTI (CUAC):** I think there needs to be a lot more work done to establish what that might be. Certainly within the energy example at the moment in Victoria time-of-use pricing is being introduced over the next one to two years. What is happening with that process is that there's a customer impact study being done which is sampling about eight different household types and housing and

various other criteria, including efficiency housing types etcetera, to see what the impacts of increasing energy pricing by the period of day is going to have on those very household characteristics and whether that will change people's behaviour for instance. I just think that before those targets are looked at you would have to do some very serious work around identifying those impacts on people.

**DR CRAIK:** Thanks. You mentioned both I think in your words here today and in your submission that some water users have special requirements for access, like those undertaking dialysis. Do you have any idea of the volumes that those sorts of things require? Are they large? I mean, if you were trying to set an essential amount of water, would they materially increase something like that?

**MS BENVENUTI (CUAC):** We can't give you the exact numbers of people affected, but they have such absolute consequences, in terms of health and wellbeing, that need to be taken into account, in the same way as people on life-support are taken into account by energy businesses when there are rolling blackouts or decisions made about those issues. There are programs where people on life-support have special consideration with the energy businesses in relation to continuing their supply or getting more information about what will impact on them. So again, I think that you would need to look at those particular groups and see what the impacts might be and what processes might need to be put in place to ensure that they are not negatively impacted.

**DR CRAIK:** Were there arrangements put in place during restrictions to deal with these people, do you know?

**MS BENVENUTI (CUAC):** I can't answer that question.

**DR CRAIK:** I suppose there were.

**MS WHITEMAN (CUAC):** I'm not sure either. I couldn't say. But I'm sure that those people - like, those on dialysis - who need a large amount of water would be able to access that outcome.

**MS BENVENUTI (CUAC):** I think one characteristic of Victorian water businesses at the moment is that they have a very good reputation, in terms of their customer service and their ability to connect with their customers around particular issues and difficulties, and I would have thought that they would be able to make those representations to their water businesses, in the same way that people are able to do that in restrictions around time of use for using hoses or other special circumstances. So I think there was some flexibility around those issues.

**DR CRAIK:** Thanks. What do you see as the essential elements of a good customer hardship policy in relation to water? What things need to be picked up if



you're trying to write a good customer hardship policy? Is there an example?

**MS BENVENUTI (CUAC):** Yes, there are examples. I think that Victoria is well served for that in water. In particular the metropolitan water businesses have hardship policies that are used as best-practice models for other places, including for energy. Characteristics I think of hardship policies would be that the hardship policy is known to customers, so that they know if they have payment difficulties they can access special staff who are able to deal with that and provide a hardship response.

Some of the other characteristics are that payment plans are put in place which take into account people's capacity to pay and that in doing so they take into account the use of water; water consumption going forward and any water efficiencies that could be suggested; water saving appliances that could be applied; flexibility in approach when people get into difficulties even on a hardship plan and I think being able to respond to individual consumer's circumstances, so flexibility around those issues is really important.

**DR CRAIK:** Do they ultimately disconnect or do they have a no disconnection policy if people don't pay?

**MS WHITEMAN (CUAC):** There's no disconnection, restriction is all that they're allowed to do. In the Essential Services Commission customer service code it specifies the times when they can restrict and I think it's if the customer has been on a - they can't restrict someone in a hardship program unless they have been on something like two payment plans in the last 12 months that they haven't kept to, so there are some requirements there.

**DR CRAIK:** They're quite specified.

**MS WHITEMAN (CUAC):** Beyond that I think some of the water companies - we're aware that South East Water won't restrict anyone who has a family, for example, which goes beyond the provisions in the code but obviously is a good thing.

**DR CRAIK:** Okay.

**MS BENVENUTI (CUAC):** I think there are very low restrictions in Victoria and that that is a very good thing.

**DR CRAIK:** Thanks. There is information around that suggests that water sewerage costs make up a pretty small percentage of household bills, less than 1 per cent usually. But billing isn't very frequent and it's quarterly mostly, as far as I understand, so bills can be I guess quite large. Would it be better if bills were more frequently, like, monthly like your phone bill? Would that be preferable for lower

income groups?

**MS BENVENUTI (CUAC):** I think we would generally support the notion that smaller bills make it easier for people to budget and to pay. Having said that, a lot of people, for instance, people on concessions often have already worked out their budgets according to the billing processes and the ones that they have to pay and they balance up their electricity, gas and water bills, depending on when they come in and their cycle. I think moving to any new regime requires some thought about those impacts on those groups but generally having payment plan arrangements and smaller billing amounts definitely helps people who are on low incomes.

**DR CRAIK:** It's a preferable way to go.

**MS WHITEMAN (CUAC):** I think to add to that we would probably support customers having the choice to do that if that is something that the businesses can implement.

**DR CRAIK:** You talked about scarcity pricing and some of your reservations about it. Do you think affordability is likely to become more a problem with scarcity pricing? I know Quentin Grafton says the average cost will be lower if it's supplied and if there is a period of water shortage obviously the price will go up. So do you see that as a problem where there are low income groups if there's some form of scarcity pricing?

**MS WHITEMAN (CUAC):** Obviously we don't know what would happen to prices and that's one of the things I don't know if we could predict, even if we could work through it. But we would certainly be concerned about that and if it did happen - there are already consumers who are struggling with affordability, so if prices went up further then there will be more and I think you only need to look at Victorian media to see that cost of living concerns are a major issue for a lot of people and water, as one thing, may not be a huge part of the household budget, although I also note that our most recent data on that isn't that recent or that fantastic. But when you consider it in concert with rising electricity prices and other cost of living pressures, it's a concern.

**DR CRAIK:** Okay.

**MS BENVENUTI (CUAC):** It is very topical and has just been the subject of campaigns in the Victorian election the cost of living issues and a focus on people's ability to pay energy and water.

**DR CRAIK:** You made some reference to social welfare policies and it's all very well to say, "Set the price and let the welfare measures deal with the low income groups because often the welfare measures don't catch up or they're not there and you

can't count on them being put in place." So what are the limitations of those welfare policies? Is it better to have it with the water retailer or is it better to have a general one?

**MS WHITEMAN (CUAC):** The limitations are obviously there's always pressure on the state government budget and they're not usually into the idea of increasing the amount of money they give to consumers in concessions. Another limitation is that you need to have criteria for concessions, programs and other similar kinds of measures and while we understand obviously the need to target those kinds of assistance measures, there will always be people that for some reason need the assistance but don't fit criteria.

**MS BENVENUTI (CUAC):** I think the other thing to consider is that taking into account some of our colleagues in other states and territories is that we're actually quite well off in terms of the concessions that apply in the Victorian context but it's very different in other states and territories. I know that within the development of the national energy market that some consideration is now being given as to developing a national approach to concessions.

**DR CRAIK:** Okay.

**MS BENVENUTI (CUAC):** But that is a very difficult thing to get through. Traditionally there has been that Mexican stand-off between the federal government being responsible for low income earners or concession cardholders and state government has been responsible for concessions and how that would play out in terms of any potential COAG work or through the national market in energy, I'm not sure, but it's even more difficult in rolling that out in Australia at the moment, given the number of water service providers in other states. So the complexity of introducing that kind of reform would be substantial.

**DR CRAIK:** You mentioned a 50 per cent capped at \$250 concession for low income earners. Does that apply right across the state for water?

**MS BENVENUTI (CUAC):** Yes.

**MS WHITEMAN (CUAC):** For eligible - - -

**DR CRAIK:** Yes, for eligible cardholders. So it's a statewide thing.

**MS WHITEMAN (CUAC):** Yes.

**DR CRAIK:** That seems a relatively straightforward sort of concession.

**MS WHITEMAN (CUAC):** Yes.

**DR CRAIK:** You've got commentary on the price elasticity of demand for water and you've noted that they're typically low. Do you think that they would increase if there was an education program of the scale that we've had for water conservation? It has really been very effective in terms of people reducing their water consumption.

**MS WHITEMAN (CUAC):** Quite possibly.

**DR CRAIK:** Do you think that would help understanding water pricing and scarcity pricing and things like that?

**MS WHITEMAN (CUAC):** I imagine it would. I don't think we really have the evidence to say anything there but it seems plausible.

**DR CRAIK:** Your submission suggests that transferring responsibility for paying the service charge to tenants means their water bills are going to increase. Do you think that's likely to be offset by a decrease in rent?

**MS WHITEMAN (CUAC):** I would think that's unlikely. I think if you talked to some of our colleagues in say the tenancy sector, they would argue that that's not really how landlords think about their investment in a rental property. Even in terms of if they're investing something extra in a property, they don't necessarily pass that through immediately in rent, they are thinking about their property investment in a different way.

**DR CRAIK:** Okay. I guess one of the issues seems to be having defined structures for consumers to participate in the whole water thing, not only when there is a reform process on but also just in the day-to-day operations of water utilities. Do they exist for the day to day in Victoria generally right throughout the state, do you know, separately from the reform process?

**MS BENVENUTI (CUAC):** I suppose we see the lack of consumer engagement happening at the national level which is a very significant issue for us in that when consideration has been given to national urban water reform that there is no capacity for consumers to be really engaged in that process for urban water reform. We're the only consumer organisation that is represented on the urban water stakeholder reference panel, for instance.

**DR CRAIK:** That's with the National Water Commission.

**MS BENVENUTI (CUAC):** Yes, through the department.

**DR CRAIK:** Yes.

**MS BENVENUTI (CUAC):** We have raised this issue numerous times that we think it's inadequate, number 1, because we're only charged with having a jurisdiction for commenting on Victorian water issues and that's where our knowledge base is and we think it's inadequate then that other states and territories aren't represented. At the policy and regulatory level we think there's, at the state level, room for enormous improvement in engagement with government around these issues and I suppose that we do think that the consultation processes that our regulator has on water issues and also on pricing reviews is good. There is always a formal process of forums and draft papers and an opportunity to respond. The water businesses in the main have consultative committees and they vary from business to business but that is a good opportunity for people to participate and there are also other processes around development of water plans and participation around those.

**MS WHITEMAN (CUAC):** We might add that we exist in Victoria and that's because we're funded by the Victorian government, so there is some support for professional consumer advocacy in Victoria as well which we would see as important.

**DR CRAIK:** Okay. Is that funding just year-to-year funding or do you know if you've got it for three years or five years or is it just year to year?

**MS BENVENUTI (CUAC):** It is year-to-year funding and it's not based on an agreement, it is based on our continued performance and the government recognising the need for that.

**DR CRAIK:** The water utilities, for instance, don't have to subscribe some of their funding to that, it is just funded directly by the state government.

**MS BENVENUTI (CUAC):** No, they do provide funding to the industry ombudsman for - - -

**DR CRAIK:** For the utilities.

**MS BENVENUTI (CUAC):** - - - complaint resolution.

**DR CRAIK:** Okay. Do you have much interaction with the industry ombudsman?

**MS BENVENUTI (CUAC):** Yes, we do. We're on the case-handling advisory committee to the ombudsman and we would have fairly regular catch-ups with the ombudsman to discuss issues that are being brought to us by various constituents across Victoria and the ombudsman also participates in forums such as the Essential Service Commission's customer consultative committee, so there is an exchange of information about what's happening in water and energy.

**DR CRAIK:** Okay. So what would you like to see? Would you like to see something like your set-up in every state in relation to water and then something national that deals with a national water reform agenda. Is that the sort of thing that you would like to see?

**MS BENVENUTI (CUAC):** We just think it's really, really urgent because, for example, our resources to work in water are around about three days a week for one staff person and there's only another maybe two organisations that spend any time at all on water issues from a consumer's point of view and that's the best probably standard there is in Australia for that kind of advocacy. We see a real need to build capacity and we believe that having the opportunity to have professional advocates who are basing their views on evidence based research and able to engage, provide some balance in terms of debates, otherwise the parties that are represented are really self-interested parties, the water businesses themselves, and we just think that that doesn't end up being a good policy-making environment.

So some of the things we have suggested are greater participation at the national level, but also we've suggested the development of a national centre for excellence around water policy and social policy. We also would bring to your attention that in energy there is a consumer advocacy panel that provides, I think, around about \$2.5 million in funding to consumer advocates to do research and to also employ policy officers to work on policy and contribute to the national policy and regulatory agenda. That has been very important in shaping the development of a national energy market. We consider water to be just as precious an issue and that it therefore requires adequate resourcing to provide that balance to reform.

**DR CRAIK:** Okay. Well, thank you. I think I've just about run out of questions. Thank you very much for your submission, particularly given your resources. Thank you very much.

**MS BENVENUTI (CUAC):** Thanks very much for the opportunity.

**MS WHITEMAN (CUAC):** Thank you.

**DR CRAIK:** That completes the presentations for today. For the record, is there anyone else who wants to appear today before the commission? I adjourn these proceedings and we will resume in Adelaide on 7 December. Thank you.

AT 2.01 PM THE INQUIRY WAS ADJOURNED UNTIL  
TUESDAY, 7 DECEMBER 2010