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PRODUCTIVITY COMMISSION

DRAFT REPORT ON URBAN WATER

**DR W. CRAIK, Presiding Commissioner
DR W. MUNDY, Associate Commissioner**

TRANSCRIPT OF PROCEEDINGS

AT SYDNEY ON TUESDAY, 31 MAY 2011, AT 8.55 AM

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DR CRAIK: Welcome to the public hearings for the Productivity Commission inquiry into Australia's urban water sector following the release of our draft report on 13 April. I'm Wendy Craik. I'm the presiding commissioner, and my fellow commissioner is Warren Mundy. The purpose of this round of hearings is to facilitate public scrutiny of the commission's work and get comment and feedback on the draft report. Following this hearing in Sydney, we will have hearings in Brisbane, Canberra and Melbourne and then we'll be working towards completing a final report to government in August, having considered all of the evidence presented at the hearings and exhibitions, as well as other informal discussions.

Participants in the inquiry will automatically receive a copy of the final report once released by government which may be up to 25 parliamentary sitting days after completion. 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 the proceedings for the day, I will provide an opportunity for any person 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. A 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, you are advised that in the unlikely event of an emergency requiring the evacuation of this building, there will be a fire alarm and then people will come and take us out, but basically you need to go out the front door. The assembly area is at the park 200 metres down the street on the right-hand side, so that's where you will be headed in the unlikely event of an emergency.

I would now like to welcome Tom Mollenkopf and Andrew Speers from the Australian Water Association. I would ask you to introduce yourselves, giving your name and position for the record and if you would like to make a brief opening presentation, we would be very happy to hear from you. Thank you.

MR MOLLENKOPF (AWA): Thanks very much, Commissioner Craik. My name is Tom Mollenkopf and I'm the chief executive of the Australian Water Association and this is my colleague, Andrew Speers, who is the national policy manager for AWA. What I'd hoped to do was to accept your invitation to just make a few opening remarks. What we would like to do this morning is to focus on just a few things in the report, particularly given the size and work that's gone into it. We don't want to reinvent it in our half an hour this morning. So if we just pick on a few of the issues that we believe deserve particular mention from the point of view of where we would be keen to see them highlighted - that is, keep them and elevate

them - a few where we have some comments and perhaps have some observations, some suggested changes, and then a few things that perhaps aren't really reflected in the report that might be considered.

Perhaps also by way of opening if I could just thank the commission for this report. When I first saw it, it was a fairly daunting sort of tome, and indeed when I first saw the media releases, I was reminded of Mark Twain's quote, "Reports of my death are greatly exaggerated." The suggestion in some media was that the water sector was in crisis, and I thought, "Well, we ain't quite dead yet." Indeed, it's on that that I would like to open. One of the observations that AWA and I think others in the sector have made is that we've gone through a great deal of reform over the last 20 or more years and there's been a huge amount achieved. The water sector broadly in Australia, not just utilities but the industry more broadly, is the envy of many around the world. It's encouraging to see that the report actually looks at the institutional and governance frameworks and the political issues which I think are to be distinguished sometimes from the participants in the sector, which I would like to suggest have done an exceptionally good job in terms of the efficiency of the quality outcomes that have been delivered. To the extent that we're looking at some of those political issues and some of those policy issues, I think that there are some good things to be achieved and there are many good recommendations in the report.

One of the difficulties that I observed looking at the report is that when one reads it, one can see the criticisms too often, but the water sector in Australia is not homogenous and so from large urban utilities and service providers through to regional and rural providers, between different jurisdictions, there are a great number of differences. I suppose my caution, not to the commission - because I think the commission appreciates this - but my caution to the casual observer would be that some of the recommendations and observations in the report will have application in some parts of the sector but not universally.

The other thing that we mentioned in our original submission, and I think it's been picked up in the report, is that the National Competition Policy reforms of the early to mid-90s have really set the stage for a great deal of advance in this sector and it seems to me that there's a great deal of unfinished business in implementing those reforms. They have been applied inconsistently across the country. Some jurisdictions have picked them up with greater vigour than others. It also appears that in recent years, there's been really a loss of traction, a bit of a loss of bottle amongst some of our governments and we've gone backwards. To the extent that this report will bring greater discipline, then it's to be commended.

Perhaps the final point by way of introduction and then I will pass to my colleague Andrew to deal with some specifics is to commend the report on not being overly focused on competition. The urban water sector is largely characterised by

government-owned or municipally-owned instrumentalities and there are opportunities for competition but the big issues are still going to confront the municipal and state-owned sector. Whilst we would I think like to applaud the desire for more effective markets and for competition to be introduced, I would be disappointed if that became the sole focus of the report and I'm pleased that it hasn't been because there's much to be done in other areas.

So with that, if I could perhaps pass across to Andrew and then we would obviously welcome the opportunity for some questions.

MR SPEERS (AWA): Thanks, Tom, and thank you, commissioners, for the opportunity to speak. As Tom says, I'm going to go through the things that we're enthusiastic about in the report, the things that we would raise some cautions about and some issues that we think should be further considered.

With regard to the issues that we support, we're enthusiastic about the intent of a number of recommendations that serve to depoliticise urban water management. So with regard to that, we strongly support the idea of having overarching and clear objectives for the urban water sector that define its responsibilities and roles and that clarify its competing priorities.

We do believe that governments have a role in setting the overall framework and objectives but within that framework, utilities should be free to manage the delivery of water and wastewater services. So to that end, we are keen on proposals that rationalise the processes for the setting of prices that speak to the issue of policy bans, the water sources that can be utilised and that address issues to do with the timing and type of augmentation that can be pursued.

With regard to the last point on augmentation, we've argued strongly in the past that there should not be subsidies for augmentation, at least not targeted subsidies. Government programs that seek to support, say, stormwater or recycling or desalination over other options we think are to be avoided. If subsidy does need to be provided and there may be cases where it does need it be, it should apply to all options equally, and the best option based on a triple bottom-line analysis should be allowed to emerge.

We're particularly concerned in that regard that such subsidies have a tendency to produce less than sustainable outcomes by favouring one option over another. As I mentioned, where we have argued in the past too against what we have termed as policy bans, in particular bans on the use of certain qualities of water for certain functions, notably in direct potable re-use and also on the trading of water between urban and rural areas. It's our view that those sorts of bans merely promote inefficiency and suboptimal outcomes. We would note also that with regard to urban

rural trades that those bans affect both the urban area and rural areas because they inhibit the opportunities for sellers to gain some financial advantage out of participating in the market.

While the commission has made no recommendation with regard to the harmonisation of regulations, it has raised the issue and we think that's important. Our view is that there is considerable scope for harmonisation of regulations and processes across the country. That doesn't necessarily mean that everything has to be elevated to the national level and we've suggested some caution in that regard in our opening statements of our submission, but we do think that there is scope for rationalising regulations. In our submission we have cited one as an example and that is the management of biosolids where the standards, the classifications, the nomenclature that exists in the various jurisdictions is different in every state and the standards that apply to the various classifications is different in every state, as is the range of substances that are regulated. That provides uncertainty for the biosolids producers and managers. It lessens community confidence in the regulatory process and the safety of biosolids' re-use and it increases costs.

On the structural reform options, we believe that the commission makes some sound arguments in support of structural reform. AWA is no enemy of structural reforms that are well planned, efficiently delivered, with clear objectives and where the cost-benefit analysis is favourable. However, we do have some concerns about the potential for there to be a reduction in accountability and planning friction between the various entities. Put simply, the overarching objective is to protect public health.

Water quality, unlike other utilities such as energy, is affected at each end of the supply chain so that qualities can be increased or decreased at each step. Where different entities are responsible for different steps in the supply chain but with no overarching responsibility for the quality of the customer's tap, there is an opportunity for or a risk that accountabilities will be reduced and outcomes will be poorer.

Similarly, where there are multiple entities existing in the supply chain, there is the potential for planning friction; that is, for a restriction of the information flows between the various entities such that planning is undertaken effectively and efficiently. We don't think that these are insurmountable problems if structural reform was to be introduced but we do want to raise the issue as one that needs to be carefully considered in any reform process.

Last year we conducted the State of the Water Sector survey, a review of 1200 participants' perspectives on water sector priorities and issues. One of the matters that emerged strongly from that is concern over highly disaggregated

structures, with a particular worry that no-one will be able to see the big picture. That's I guess just a simple way of referring to the planning friction that I have discussed. Of the various options put forward by the commission, we have clearly no objection to option 2. Such structures exist; there are separate bulk water and retailers.

Option 3, including disaggregation of wastewater suppliers potentially raises some other issues simply because wastewater is geographically constrained in some circumstances. It doesn't move freely across the landscape, we want to take advantage of gravity, so we locate facilities in particular locations. That creates what is tantamount to a natural monopoly in some circumstances, so the opportunity to gain real efficiencies out of that sort of disaggregation we think is somewhat unproven.

Option 4 obviously exists. The Melbourne retailers are an example of that. So once again, we're not arguing against any of those options. In particular, we are raising some warnings with regard to the opportunities that might emerge. With respect to option 5, which is a more or less fully contestable model and other models that might include strategic grid managers and pipeline managers and so on, we think the benefits are yet to be realised. There was significant concern expressed in the State of the Water Sector survey about those models.

With regard to the role of economic regulators, we believe that economic regulation has been very effective in this country for a number of reasons. First of all, it introduces disciplines that have not existed in the absence of a market in the past. A focus on strategic asset management, a focus on efficient delivery of goods and services are all matters that have received a great deal of attention in the regulatory environment that we have. The existence of independent regulators also depoliticises the process, in that there is the opportunity for politicians to claim more or less, "The independent regulator made the decision, it's out of government's hands." It creates independence in decision-making to a significant extent and it minimises the opportunities for prices to be set by fiat.

We agree with the commission that there's the opportunity to move to a light-handed approach but such approaches should be well designed and preserve the features that I've just referred to. With regard to pricing specifically and the proposal that utilities ultimately set their own prices with light-handed review periodically, we have no in-principal objection to that but we do feel that that process would lessen the protection afforded to utilities from political interference. I've mentioned this issue several times. There are numerous examples, as you would well know, of political involvement in decision-making, in servicing options, in augmentation options and so on. They produce inefficiencies of note and therefore we are arguing strongly for processes that preserve a regulator framework that enable those political

interferences to be minimised.

The commission has raised issues of developer charges without making a specific recommendation but we would like it to be noted that we strongly believe that developer charges should achieve full cost recovery, and that's not just for local area reticulation but also for headworks charges, the upstream costs that are incurred because of the development of a new area.

With respect to the removal of restrictions, we agree that water restrictions are a blunt instrument and that they inhibit consumer choice unwisely. However, in better aligning government water conservation messages, we would like it noted that it's important that the community not be given the perspective that water conservation no longer matters. It remains important. Similarly, we do believe that there is room for permanent restrictions in some areas. These are what we term the "no regrets options", matters such as bans on toilets other than low-flush toilets or dual-flush toilets, bans on automatic sprinkler systems being set to irrigate in the middle of the day. There is no utility loss and no real cost to consumers of those options now that they're embedded in the market and we see no reason that options like those and others - where the cost to consumers is significant less than the benefit gained, we feel that there is room for those sorts of bans to remain.

With regard to amalgamation of smaller utilities, once again we think the commission is on the right track with its recommendations there but we would make two comments: one is that caution needs to be exercised in making sure that particular local councils are not denied a critical mass of abilities to provide their other servicing options. There are steps that could be taken to prevent that from happening such as a newly created GTE contracting back to council for provision of the services that it needs, but these things need to be thought through.

Similarly, we would note that whatever GTEs or amalgamated enterprises might emerge, they don't necessarily have to be contiguous with existing council boundaries. There is benefit to be gained from GTEs being based on more of a catchment basis, so there's a variety of approaches that could be taken. Similarly, we think there is also scope for greater cooperation between smaller utilities which may eliminate some of the problems that are referred to but still produce some of the benefits.

We mentioned at the outset that there were two matters that we wanted to raise for further discussion. One is to do with planning. We believe strongly that there is still a role for a master planning process; that is, while we note that the commission does say that water utilities shouldn't be actual or de facto planners, and we agree with that. We do feel that there is a role for planners and the particular objective that we would seek is to have the opportunity for water utilities to provide real and

meaningful input into the urban planning process.

Our final issue is to do with externalities. The 1994 reforms suggested that externalities should be internalised, particularly those associated with environmental degradation. The National Water Commission, in its various biennial assessments of progress, have noted that very little progress has been made in that regard, and we believe that more progress does need to be made. The commission's report recommends harnessing of market forces in a number of ways and confronting consumers with the real cost consequences of their decisions, but as long as externalities are not internalised, the signals sent to consumers through prices are not accurate, and similarly, for utilities, the various options considered for system augmentation or expansion may not be properly assessed where externalities are not included.

I'm conscious of the fact that I've spoken fairly quickly but I do recognise that our time is limited. As Tom said, we are happy to take any questions on those issues or any others raised in our current submission or the previous submission. Thanks for the opportunity.

DR CRAIK: Thanks, Tom, and thanks, Andrew, for that. Thanks for your submission. I'll ask a few questions because we've only got about 15 minutes and we have a number of people appearing today, and then Warren will ask a few. Economic regulation, our recommendations probably raised more comment than most of our other recommendations in the report and you suggested today and in your submission that it reduces the opportunity for political interference in price setting. Just two questions: firstly, if our reforms to governance were introduced, trying to reduce political intervention, do you still think there would be a need for regulation? My second question is: in those places where economic regulators do set prices, I suppose over the last six to eight months we've actually seen more political intervention in those places where economic regulators do have a role in price setting more so than we have in other parts of the country. So I guess I seek your response to the comment that it kind of removes political intervention, because I'd have to say recent experience might raise a few questions about that.

MR MOLLENKOPF (AWA): Perhaps I could express it in terms of the difference between strategy and deployment. The fact that the deployment hasn't been ideal in terms of our approach to independent economic regulation doesn't necessarily mean that the strategy is flawed. Our observation was that in the absence of independent economic regulation, the opportunity for routine political direction and in fact possibly the community expectation that it is the role of governments of the day to intervene in day-to-day pricing or management decisions would be enhanced. It struck us that just as one of the recommendations of the commission was to have clarity as to the expectations of the sector, so too clarity about the pricing principles

and who may intervene on what bases was important.

DR CRAIK: What about the issue if the reforms to governments and institutions that we have proposed were in place, which in some way is accompanied by some of our recommendations on providing the information to communities - so that may change the community's expectations about the role of political processes in price setting - does that in any way mitigate in your view against the need for economic regulation in pricing?

MR MOLLENKOPF (AWA): I think that there are some sectors of the community that are quite sophisticated and have both the interest and the skills to actively participate in a conversation about pricing and in fact other key decisions. But the reality is that there are also many parts of the community that delegate that to - whether it's community groups, or there's an expectation that government will set in place structures to look after their interests there. So I don't think it's a case of one or the other. The governance reforms will perhaps go some way towards ameliorating that but my concern would be that, in the absence of absolute clarity, we're going to go further backwards with political intervention. Our request would be for greater strengthening of the role of independent regulation in that sense.

DR CRAIK: What about the notion that we proposed in our report, where there is currently actual price setting by economic regulators and if the governance arrangements we proposed were put in place, over a period of time that gets reviewed and then if things are satisfactory, then you move to a process of price monitoring, so it's a staged process? So you get the governance right and you get the expectations right, the community is used to price setting, price monitoring and regular reviews, what about that sort of process? Do you believe that that would overcome some of those issues?

MR MOLLENKOPF (AWA): I couldn't discount that. It's quite possible that that would be effective.

MR SPEERS (AWA): One of the things that we've noted in our submission is that in certain environments, the light-handed approach and the stepwise methodology that you propose may be effective. For a Sydney Water, a Melbourne Water that has been through the discipline of economic regulation for a number of years, has clarified its business processes accordingly, there is, we think, potentially scope to move to a more light-handed approach. That may not be universal though. If we're talking about the creation of new GTEs, amalgamating smaller utilities or creating structural reforms that might disaggregate various entities in various ways, there may be a need for a stricter, for want of a better term, approach to be maintained for some time to introduce the disciplines to business processes that are now present in a Sydney Water or a Melbourne Water or a Water Corporation.

So the short answer to your question is yes, we agree that that might be a methodology that would give us some security but it may not be applicable or appropriate in all circumstances.

DR CRAIK: Okay.

MR MOLLENKOPF (AWA): Commissioner, if I could just add one thing: it may sound strange for the industry to be saying that there's an enthusiasm for some form of regulation. The rationale is not because we don't believe that the industry itself is capable of being responsible, and in fact it's done a great number of things in terms of transparency. I'm sure the industry could be trusted to engage with its communities and other stakeholders. The concern that we have is that if we're going to have full cost recovery which is absolutely vital. What we don't want to see is that every time that there's pressure on prices that governments seek to intervene to artificially constrain them without making some compensation.

DR MUNDY: You make the point that one of the reasons why politicians might find independent regulators helpful is that responsibility can be outsourced effectively to them, but similarly, boards have the same option, don't they, that they can turn to their communities - and I'm interested in your notion that water utilities who are led by effectively appointed officials are in some sense more able to engage with their community than elected officials; that's a political economy point. But I find it curious that there's this suggestion that we need independent regulators setting every price and at what cost, but I just wonder whether the ongoing presence of regulators raises governance concerns. We hear an awful lot about, "Let's get the politicians out," and sometimes Treasuries are enjoined to this argument and sometimes environmental regulators are enjoined to this argument. But it seems to me that all of these are potentially undermining robust governance frameworks and accountabilities for the people who claim that they're running a business. So do you think there's an interaction between the two?

MR MOLLENKOPF (AWA): There is a continuum there. One of my observations about the UK is that sometimes I think that the UK water companies are more interested in negotiating their regulatory outcomes with the price regulator than they are in looking for efficiencies in their business or being responsible for managing their business. I think one of the good things about the Australian sector has been that we haven't gone down that path. So it's not a black or white situation here. Our interest was in not abandoning the idea of some independent oversight. Where that sits on the continuum is perhaps something we need to talk about in more detail.

DR MUNDY: I guess the confusion has sort of been around you can have

independent regulators doing all sorts of things and it's a question of what sort of things you want and what you want them doing. We have seen ports in Victoria transition from price setting to essentially a very - obviously there's a complaints mechanism, but you made the point about maybe Sydney and Melbourne are at a mature stage where the regulator could pull back, and that's what the Victorian ports have been doing. How long do you think this process is? It is five years? Is it 15 years? What's the scope of this, or is it an outcomes based thing and what do the outcomes look like?

MR MOLLENKOPF (AWA): The first step comes from having that clarity in terms of the governance framework that we have established. One of the things that about the Victorian model or the Melbourne model in particular was that there was quite a clear institutional and governance framework that was established there in the mid-1990s. There was no wavering from it and my observation was that it was only a matter of a couple of years that the entities actually got up to speed with their respective roles there. So it comes down to that clarity of vision and expectation.

MR SPEERS (AWA): If I might add to that, I think there is a point well made there, that we're looking at outcomes rather than processes. Organisations that have had the discipline of looking at their assets, valuing them properly and so on probably can move down the path to a more light-handed approach more quickly than some smaller entities that might be created in future that don't have that skill set and could be usefully guided in that respect.

DR CRAIK: Thanks. You talked about developer charges and you suggested that - because we were talking about where should they be applied and how they should be applied - and you note the additional load placed on water mains and headworks isn't always reflected in developer charges and they should be. Can you explain why that is the case and how those costs should be incorporated?

MR MOLLENKOPF (AWA): At the moment in Victoria, there is no variable headworks charge that is levied. Previously there was an economic signal sent to developers where they were developing an area either out of sequence or in a remote area. The internal works tended to be constructed by the developer under a QA process but the external costs were recovered by the utility of bringing services into that area. Now, those developer charges no longer exist, those external charges. So the consequence is that there is no economic signal sent to these developments other than the internal cost of servicing which is borne by the developer themselves.

DR MUNDY: I just had two quick questions. You expressed some concern about our suggestion that the statewide utilities in the centre of the country and west, some care needed to be taken that regional and remote communities weren't left behind. My question is in two parts: (1) does that mean that you're concerned that regional

and remote communities in New South Wales and north-west New South Wales and Queensland have been left behind because of the structure of those states' arrangements and, secondly, having some knowledge particularly of regional Western Australia, do you see any benefit in more locally focused utilities which might be of a reasonable scale, such as perhaps was developed in Victoria, and particularly given the very peculiar industrial needs for water that exist in a number of parts of Western Australia which are relatively arid?

MR SPEERS (AWA): I think what we're raising here is a cautionary note rather than a statement that would argue against making those state based utilities smaller and more locally focused because clearly there is advantage in that in many circumstances. Our note was really that Australia struggles in a number of locations to provide water services to rural and remote communities that meet the standards that we would expect. At the moment, in a number of states with very large utilities, there is significant effort directed to redressing that situation and the skills available to those regional and remote areas are in fact available because of the existence of the larger entity which is well staffed.

So we're merely saying that if it is proposed that the state based utilities be broken up in some way, that particular consideration needs to be given to the needs of those rural and remote communities so that they aren't left behind. We don't think that's necessarily an argument against reform in those large utility areas, but in that reform process, particular regard needs to be had to those situations.

DR MUNDY: Their guiding charters would need to make it clear that that's part of the gig and that they were of sufficient scale to be able to do it.

MR SPEERS (AWA): That's right. We wouldn't like them to be serviced by essentially a provider of last resort. We would like them to be serviced by a well-staffed and capable organisation.

MR MOLLENKOPF (AWA): You mentioned Victoria; Victoria is in some ways unique in obviously the size, the density of population, and notwithstanding that it's probably the best able to have strong regional authorities, you will have observed that some of them have still been under financial stress.

DR CRAIK: We have observed.

DR MUNDY: All of them make negative returns despite the independent regulator. Just one other question: you've provided some really useful information on standards on biosolids which is very helpful. You mention on page 5 of your submission that there's been a tendency for regulators over time to increase standards once the service grant has been achieved and this issue of ratcheting up. I know we're pressed for

time but if it was possible for you to just draw our attention to a couple of those sorts of examples because it's a matter that's of some interest. If you want to shoot as an email or some links about where they are, it would be very helpful.

MR SPEERS (AWA): I think we would be happy to do that and with regard to the biosolids issue, the partnership that we referred to has done a report on regulation across Australia and New Zealand, and while that was prepared for the members of that, I don't think that there is any barrier to us providing you with a copy, so I will forward that as well.

DR CRAIK: That would be helpful. In that issue of ratcheting up, if there's any information on the process that was gone through in that ratcheting up, that would be useful as well because I guess one of the things that we're interested in are the costs and benefits analysed in the process of ratcheting up.

MR SPEERS (AWA): Okay.

DR CRAIK: Okay. Can I thank you both very much for coming along, thank you again for your submission and thank you for your comments and answers to questions. Thank you.

MR SPEERS (AWA): Thank you.

MR MOLLENKOPF (AWA): Thanks very much.

DR CRAIK: Next, we have appearing IPART and Jim Cox. Jim, if you and your colleague could state your name and your position for the record and then if you'd like to give a brief opening statement.

DR CRAIK: Yes, I'm Jim Cox. I'm chief executive officer and full-time member of IPART.

MR CHAPMAN (IPART): I'm Scott Chapman, the senior analyst in the water group of IPART.

MR COX (IPART): Thank you very much for the opportunity to speak today. Just perhaps recording I think we made a fairly comprehensive submission to the initial round of submissions and the Productivity Commission have now released a draft report which is a very wide-ranging report and we've made a subsequent submission, commenting on just some of the topics that were discussed in the draft report. So I guess our two submissions should be seen together.

To just talk about some of the issues we talked about in our submission, perhaps the first point is that we in general support the high-level governance reforms that have been proposed by the Productivity Commission. For example, we are I think fairly keen that there should be clear standards and that standards and decisions to invest in infrastructure should be based on careful evaluation of all the options. In particular, we think that the costs and benefits of standards that have implications for prices should be investigated perhaps in more detail than has often been the case in the past. So we're certainly on the page with you there.

It's perhaps worth noting that we ourselves have done some work on the productivity of New South Wales state-owned corporations in recent years and what we found is that in recent years, the productivity of these organisations has declined, largely because governments have required them to undertake investments not always with a view to wide economic efficiency considerations.

I think we have seen in New South Wales government and enterprises a decline in productivity in recent years. To some extent, I think that's unavoidable. They are making investments that are going to produce benefits in future years and you would probably expect to see that, but it's not clear that those decisions are always made with a full weighing of the costs and benefits of these decisions. So yes, we would support, if you like, development frameworks to enable more transparent trade-offs between the government's objectives for the sector. Similarly, we think that the performance expectations in the sector need to be clearer than they are now.

In terms of the way forward, we think that - this is in the New South Wales

context - that government's shareholding role needs to be strengthened. We suspect, and I think they would agree, that New South Wales Treasury have not always the most effective shareholder - if you like, representative of the shareholder - in the past and I think that needs to be attended to, and I think probably at the government level, the government's own role as a shareholder needs more clarification than has been the case in the past.

Similarly, the separation between the portfolio and the commercial interests of the government needs further attention, at least in New South Wales. So those are areas where governance needs further attention. There's an element here of, if you like, a counsel of perfection; it's easy to say these things, and they're right, but they don't always happen and they don't happen consistently, so I think we've got to accept that while these things are right in principle, they don't always happen and there are reasons why they're not always followed as much as we might like. That I think is part of reality here.

You will not be perhaps surprised to learn that we have reservations about the commission's suggestion that government-owned services could be effectively regulated through price monitoring, so we do not agree with that, and that's argued in the submission. I think it's important to say here and to consider what the record of regulation has been. I think we've had now regulation in New South Wales for 19 years and we've been doing it for 19 years. I think what that has resulted in is a consistent focus on efficiency. Because there's a regulator, there is someone in the system that cares about efficiency and that wouldn't always be the case and it wouldn't be the case consistently if there wasn't an institution concerned about efficiency.

I think, secondly, there have been important price structure reforms. I think that's a clear achievement of the regulator. I think, thirdly, and very recently, we have seen the importance of the regulator as the transparency agency. Particularly in the work we've done in electricity, IPART has very clearly been able to point out to people the reasons why prices are increasing. I think this is a very important public service. The fact that attention is drawn to the reasons for price increases is clearly leading to policy changes. I am not sure how that transparency benefit would have occurred in the absence of regulation.

I've said if you look at water, what we've seen in recent years is the government's decision to invest in perhaps alternative sources of water supply in the drought and that has been pushing up prices. It's been pushing up prices quite substantially. I think an important function of regulators is to draw people's attention to that, so that they do understand the reasons why prices are increasing.

Thirdly, and I think it's important to note, the community as a whole in my

view derives confidence, particularly in the case where prices do need to increase, that the regulator is monitoring that and explaining what's happening and ensuring the price increases are no more than they absolutely need to be, given the circumstances that are there. I think there are, in practice, and given the imperfections of government, important services that regulators have provided and we should think carefully before we assume that some loose monitoring arrangement would provide all the benefits that regulators provide.

We've said that price regulation is perhaps a stronger form of regulation than price monitoring. It provides a budget constraint. It provides frameworks for the evaluation of costs and performances and also regulators can remove cross-subsidies. I really don't think something like, if you like, a price-monitoring arrangement or a charter between utilities and the government is an alternative to what regulators have actually done in practice.

The third area I wanted to comment on was scarcity pricing. That's something we have been interested in. We have said and we will examine scarcity pricing as part of our review of the charges that the Sydney Catchment Authority charges Sydney Water. We will be focusing our analysis on the merits of scarcity pricing, given the various problems of implementing it at the retail level, so we think the wholesale market is the place to look. As you know, there's been a recent paper from Frontier Economics that's been commissioned by the National Water Commission and there's some useful work there that we will examine and we will consider these models in our issues paper which will be released shortly for the inquiry.

Obviously we've not made up our minds on this but I think there is an important opportunity arising in Sydney to see what part scarcity pricing might play in balancing supply and demand, particularly about water level. Obviously there are administrative controls there as well, but I think the question of what price has to add to that is one that is worth examining. Given the diversity of water supplies now in Sydney, this is a good time to do so. So those are just a few opening remarks, but we'll be happy to answer any questions.

DR CRAIK: Thanks very much, Jim. Thanks for coming along and thanks for your comments. Going to the issue of pricing first, and we're certainly interested in your comments there, and you made the comment - and your submission does too - you don't see strength in governance as a substitute for it, and think that robust regulatory arrangements require more than price monitoring. I guess that's based on your understanding of history. So I guess we'd be interested to know why you think price monitoring - if the utilities were subject to all the governance arrangements that we've proposed, are there other governance arrangements that would be required? Can you envisage a point where price monitoring would be a satisfactory arrangement? Are there other governance arrangements or other requirements that

need to be in place before you could envisage price monitoring being a satisfactory state of affairs?

MR COX (IPART): I guess I'm doubtful about that. At the end of the day, we are experiencing New South Wales - you know, New South Wales has in theory very good governance arrangements; it's just what happens in practice is not what those governance arrangements actually purport to be. That's just the reality. So it seems to me to be a bit unrealistic to say that there could be an ideal framework of governance actually being applied. In reality, politics would get in the way and always does. I think in this context, the role of the regulator as a transparency agency becomes very important. Maybe in an ideal world, an ideal government and an ideal utility, some sort of contract might work but I don't think we live in that world.

DR CRAIK: It's clear - and we had this discussion with the AWA - that the presence of an economic regulator doesn't guarantee against intervention - - -

MR COX (IPART): No, it doesn't. I think that's correct. I think we have seen in recent years that governments in a way have tried to circumvent the regulatory arrangements through things like giving directions to regulators, and that is true, but I think what the regulator can do in those circumstances is say, "Look, this is the direction you've got," and, "Look, this is what it means for prices," so at least the public is informed about that.

DR CRAIK: I think we've seen in the last six months or so where there are economic regulators involved in price-setting issues. In a number of states of Australia we have seen political intervention where there is economic regulation and where there isn't.

MR COX (IPART): I think political intervention is a reality. The way that we have done it is to ensure that any direction that comes to us is made openly, what we call a 16A direction in our act, so that's on the public record, and we would ensure in our reports that we explain what the direction was and what its effect is on prices, so that people understand what has happened and if they wish, can hold the government responsible for the choices that they have made. As we're now living in an era where cost of living issues are a very important political discussion, I think that's a very important contribution that the regulators have made.

DR CRAIK: I'm sure Warren has more questions on this but I've just got one more on this general issue. The way the Victorian ports have gone, in terms of the economic regulator set prices and then they went to price monitoring and now some of them, they set their own prices but there is a complaints mechanism in place with periodic review, do you think that sort of staged framework has possibilities?

MR COX (IPART): I don't know very much about ports in Victoria, so I really don't understand how well that's worked, and if it's worked, why it's worked. I think if you look at water, we're looking at an essential service with strong social policy connotations, low elasticity of demand, strong emotional appeal, I think a high level of concern among the community that prices should be no more than they need to be. So I think it's perhaps a different circumstance to ports in Victoria.

DR CRAIK: Okay, thanks.

DR MUNDY: You talked a lot about the benefits of independent regulation and mentioned none of the costs. The literature is replete with costs.

MR COX (IPART): Yes.

DR MUNDY: We don't need to revisit those. I would be interested to know - and we're more than happy to take this on notice - how much IPART spends regulating the water sector in New South Wales each year and what you spend it on, particularly in price determinations, and also if you have any idea what it costs the utilities to comply with the water requirements because I'm sure you pass that through as a legitimate cost, so if you happen to know off the top of your head, that's great, but if you want to give us those numbers - - -

MR COX (IPART): I would probably have to take that on notice to some extent, but IPART's overall budget is about \$20 million a year. For that, we regulate electricity, gas, water, public transport, local government rates and we administer environmental schemes on behalf of the New South Wales government. So I would think the water component at a guess is five million a year. Obviously we do impose costs on the utilities themselves, I wouldn't deny that. We also impose costs on third parties in the process of making our inquiries, as you do. You sort of appreciate the effort that people make to come and help you. So yes, there are certainly costs.

There may also be costs in terms of the way in which utilities make decisions, but I think as the previous speaker said, in some ways I think we have required the businesses to be more professional, the way they do things, and that's not always a constant. Just to give one example, one of the things that we found recently is we need to encourage a business to concern itself more with things like succession planning, quality assurance in the work he does across the organisation. Some organisations, as we all are, are getting older. They're going to lose a lot of their very senior staff in the next year. These are issues where regulation might encourage them to take action rather earlier than they would have done. So it is a complex situation, but I don't deny that there are costs.

DR MUNDY: Please don't take this as a criticism of you, because it's not, but I find it extraordinary that a price regulator would have to suggest to a government-owned business that it needs to attend to - I mean, I'm a director of a Commonwealth government-owned business, and the notion that you weren't concerned is something I find extraordinary, which I think presumably is a reflection of the previous comments that government supervision in New South Wales by the Treasury mightn't have been what it should have been.

MR COX (IPART): To be clear, this was in auditing functions rather than price regulatory functions, but I'm happy to send you a copy of the relevant - - -

DR MUNDY: Sorry, I just find that extraordinary. You talked about the regulator, being the institutions, concerned about efficiency and it's something that we concern ourselves with an awful lot, and I'm interested in the chart that's on page 9 of your submission and your observation that Sydney Water opex in real terms fell between 93 and 96. There doesn't seem to have been an awful lot of progress made since. Is that because all the opex savings that are available have been weeded out? You made an observation about the capital which I take on board which would contribute to some opex creep, but it seems that there's been little progress in real terms when indeed through the period 96-2003, there was a substantial deterioration back to even poorer levels than 1993.

MR COX (IPART): Firstly, I think the observation you're making is correct. The bigger savings were made in the earlier years because that's when the savings were available to be made. I suspect what's happened to some extent is that there's been an increase in the level of service required of these organisations. It's perhaps clearer for Hunter Water than for Sydney Water. For Hunter Water, there's tended to be an increase in operating costs really because the standard of service being provided, both in the water side and the sewerage side in Hunter Water, was relatively low, so there's been an upgrading of service standards. I think in the case of Sydney Water in recent years, we've got to remember we've gone through a very prosperous period and I think the standards that the community accepts have risen, so more is expected of Sydney Water and it probably has meant that the reduction of operating costs is certainly less in more recent years than it has been in the previous period.

Having said all that, I think we're now entering into a period of increasing concern about cost of living pressures, so I would expect the focus to be placed again on the cost side going forward.

DR CRAIK: But even from 2003 to 2007, again - I mean, costs reached a high and then they actually dropped 25 per cent.

MR COX (IPART): These may be accounting issues, the year-to-year changes or

the vagaries and mysteries of accounting, but I think what you can see in the more recent years is the level of the mid-1990s has been - - -

DR MUNDY: If you want to get back to us and have a think about it, that would be helpful. You just raised the issue of concerns about cost of living pressures, about expectations. It would seem to me that an efficiency focused regulator should be focused on efficiency, not cost of living pressures, but it's more your point about community expectations. How do you determine that? We have made some proposals that would suggest that there might be better ways of informing what community expectations are but I'm interested in how you and the other commissioners of IPART formed that view about what the community wants.

MR COX (IPART): It's a good question. In many cases those decisions are made by governments, rather than ourselves. For example, the desalination plant is an important increase in the level of service provided to the Sydney community. That was ultimately a decision made by the government following an election campaign in which - the desalination plant was one of the issues that was mentioned in the election campaign. That was a political decision taken out of our hands. We were asked to ensure it was being achieved in the most efficient way possible.

Many other issues, such as discharge standards of waterways, those are set by the Office of Environment and Heritage, those standards. Obviously for those sorts of decisions, we do our best to encourage them to ensure that the benefits of those decisions exceed the costs. There are a number of things that we ourselves do. For example, in the operating licence, we set various system performance standards and various customer service standards and those are things that are IPART's decisions. In deciding what those would be, obviously we would consult very carefully with the organisations themselves to get some understanding of what costs and benefits of alternative standards there might be from their point of view. We also consult carefully with various consumer representatives as to their views about what those standards should be. Beyond that, I think there's perhaps a role - and we haven't perhaps done this as much as we should have done - perhaps looking at surveys to understand what people's views about these things are, bearing in mind that water bills are often a fairly small bill and people may not have very strong views about a lot of these things, so I think we've got to be realistic about all of that. But we do try and inform ourselves as to what the consumer wants in these areas as best we can.

DR MUNDY: You've reflected a couple of times on the desal plant and we've had an opportunity - because New South Wales is so transparent - to have a look at the correspondence from the minister to your chairman who is soon to be elevated to higher office, one would hope.

MR COX (IPART): Yes.

DR MUNDY: You mentioned that you were asked to make sure that the desal plant was done at least cost. Have you concluded your consideration of that?

MR COX (IPART): We did that for our last determination.

DR MUNDY: Maybe I'll just cut to the chase: you were satisfied it had been done at least cost?

MR COX (IPART): We were satisfied it was done at least cost, yes.

DR MUNDY: That's including the financing arrangement or just the capital expenditure?

MR CHAPMAN (IPART): When we did the original determination, the desal plant had not been completed. It was still in 2008 through construction. At that point we reviewed what had been spent, what was planned to have been spent and that allowed for the efficient costs of that.

DR MUNDY: So the issue as to how it might be financed is really not a matter of - how the business finances itself is not something you've concerned yourself with; a return on its capital and how it raises its money and provides equity as - - -

MR COX (IPART): I guess that's right. What we looked at was the efficient costs where the spending was efficient.

DR MUNDY: Okay.

DR CRAIK: That included the cost of the renewable energy to run the thing?

MR COX (IPART): I think we took the view that the requirement to use renewable energy was government policy.

MR CHAPMAN (IPART): We're going to have a thorough look at that over the next year as well.

DR MUNDY: The direction that you've received from the minister, Mr Pearce, I think his name is, seems to - I guess I'm seeking your clarification on this - imply that there will be a fixed charge that will cover all the fixed costs and there will be a variable charge that will cover the variable costs.

MR COX (IPART): This is for the desal plant?

DR MUNDY: For the desal plant, yes.

MR COX (IPART): Yes.

DR MUNDY: The instrument he issued you under section 52.

MR COX (IPART): Yes.

DR MUNDY: Would it be your expectation that that fixed component will simply flow through as a fixed charge on to the customers of Sydney Water much in the same way that the desal plant costs were passed through in Adelaide?

MR COX (IPART): I don't know that we've yet concluded any of that. This is an inquiry that we've been asked to do just very recently, so I think at this stage, all we would do is work out the price the desal plant should charge Sydney Water. I guess how that's passed through to Sydney Water's customers is an issue that will require subsequent consideration in our review of Sydney Water's own charges.

DR MUNDY: Fixed changes in Sydney Water's cost base would normally pass how through to customers?

MR COX (IPART): We probably don't think about it in those terms. What we have tended to do is to work out what Sydney Water's overall revenue requirement is, then work out what we think the usage charge should be, based on the marginal cost, and the fixed cost is the rest.

DR MUNDY: So it will just enter as a cost?

MR COX (IPART): I would think so.

DR MUNDY: Okay. Do you have a sense that your consideration of this direction from the minister will impact in any way consideration of the bulk water prices set by the Sydney Catchment Authority and do you think this direction will cause any change in how you might have approached scarcity pricing for the water coming out of, primarily, Warragamba?

MR COX (IPART): I think the relevant consideration there is that, moving forward, there are going to be alternative sources of bulk water in Sydney. I think the issues for the catchment authority is that we have a fairly large component of their revenue being recovered for the variable charge, but their revenues will be more variable in future because the amount of water they take will be more variable in future. I guess there's a question of risk allocation there and whether ultimately, a move towards greater reliance on a fixed charge for the Sydney Catchment Authority

is appropriate, so I think that's an issue that does deserve consideration.

DR CRAIK: Can I just ask on full cost recovery, the Office of Water in New South Wales considers that full cost recovery is achieved by the economic real rate of return, and on the return on assets is greater than or equal to zero. Our view would be that returns at this level don't actually provide any returns to debtor equity. OTTER in Tasmania has suggested a real rate of return of around 7 per cent is consistent with full cost recovery, and I think the Productivity Commission itself in a report a couple of years ago suggested something like 5 to 8 per cent. So we'd be interested in your views about the approach taken by the Office of Water to assessing full cost recovery and I guess whether you think businesses that earn consistently low or negative real rates of return over consecutive years are likely to be on track to meet capital requirements.

MR COX (IPART): Yes. If we look at what we've done, we've tended to determine rate of return in the order of 7 per cent real for the organisations we have set prices for, such as Sydney and Hunter, and also Gosford and Wyong councils, so I guess our view would be that a real rate of return is needed to reward investors in those industries. I think that's what we have done. I guess the corollary for that is that very low or negative rates of return - I think it's questionable whether full cost recovery has been achieved there because, after all, the capital has an opportunity cost.

On the other hand, the Office of Water may have other not economic reasons for proposing those policies which might be worth exploring. But I think, yes, you'd have to question if full cost recovery has been achieved at those very low rates of return.

DR CRAIK: So you think the OTTER suggestion of around about 7 per cent is in the ballpark?

MR COX (IPART): I think it's in the ballpark. The only thing I would say is I do suspect there are communities, including communities in New South Wales, which may have not the capacity to pay a full cost recovery, so I think there is an issue of equity there as to how they can be given standards of service at a reasonable level where there may not be the capacity to pay.

DR MUNDY: But major Tasmanian towns like Launceston, Hobart and Devonport probably don't fall into the category of communities you're contemplating.

MR COX (IPART): That wasn't what I was thinking of.

DR MUNDY: To be fair to Tasmania, they do have communities of that nature,

particularly in the south-west.

DR CRAIK: I think we recognise that issue in our report, that there are likely to be some communities that can't possibly do it and maybe there is a case for transparency to make sure we get adequate funds to provide services of adequate standards, yes.

DR MUNDY: To follow up on that, your expectation would be in a community, a major country town, eight, 10 thousand, 15 thousand, 30 thousand people, you would expect to see some sort of positive return consistently over time?

MR COX (IPART): Let me see; we've looked at Gosford and Wyong. Those are communities of, what, 100,000 people. There is certainly, we have determined, a rate of return there. Scott, can you remind me what we did for Broken Hill?

MR CHAPMAN (IPART): That was before I started. That's about 10,000 properties, I believe. We certainly gave them a rate of return on a nominal regulatory asset base, between 6 and 7. I can't quote the exact number but it's around that level. They asked for a lot more money than we gave them, significantly more, but from where we stood, that was over-egging it a little bit, so we constrained the regulatory asset base essentially and applied a real rate of return between 6 and 7 per cent which is our standard practice.

MR COX (IPART): So as an example of what we've done when we had to encounter the difficulties of a small community with capacity to pay issues.

DR CRAIK: A small, regional community, yes.

DR MUNDY: Can I just ask what the rationale for regulating Broken Hill is and not Tamworth?

MR COX (IPART): It's a very good question.

DR MUNDY: It's what we do here.

MR COX (IPART): I'm not sure the rationale would necessarily withstand very strong scrutiny. But Broken Hill, their water business is part of Country Energy, so I think it's a Country Energy connection more than to us. We don't look at larger country towns.

DR MUNDY: So we've complied with the ancient regulatory thought that we don't regulate on the basis of corporate form.

MR COX (IPART): Something like that, yes.

DR MUNDY: Just coming back to the desal plant - because I was desperately trying to find the sentence - in the minister's direction at point 4, "The structure of prices should encourage SDP," that's the operator of the desal plant, "to be financially indifferent as to whether it supplies water or not."

I guess my question is in two parts: (1) how do you interpret that and (b) what does it imply for the equity component of the cost of capital? It seems to me that a producer who is indifferent to supplying his product or not and is guaranteed revenues on that basis by a regulator should have a very low equity base, if it isn't zero.

MR COX (IPART): All I can say is I think these are very good points. These are issues that we all need to consider as we work through that issue of the desal plant. I do think that what is an appropriate rate of return for an organisation with those risk characteristics is a very important issue. I think it's probably not one we should make our minds up on at this stage, but I do recognise the point.

DR MUNDY: So you're still working through what this notion of financial indifference to providing product might actually mean in an operational and regulatory sense?

MR COX (IPART): In a way, we operate in a similar way as you do. What we will do is shortly prepare an issues paper that will discuss these issues and we will invite responses from various interested parties and we'll need to work through those issues but I think you do raise a good point.

DR MUNDY: Just one further question on that: is this the sort of phraseology that's ever been used in a direction to IPART before?

MR COX (IPART): What phraseology are you referring to?

DR MUNDY: "SDP shall be financially indifferent to whether or not it supplies water." Is that something that has been given in relation to Sydney Ferries or local governments? It's peculiar words and I'm trying to see if there's any precedent on the public record that we might be able to have a look at.

MR COX (IPART): I'm not aware of that.

DR CRAIK: Jim, moving on to a notion that we raised in our report about utilities offering different service offerings and different tariff options to go with different service offerings (1) we think that's a good idea and, secondly, do you see that possible under some kind of regulator price-setting - - -

MR COX (IPART): So particularly this is the idea that you might have a high level of security of supply, so that when there are water restrictions, some customers would - that sort of idea?

DR CRAIK: More saying under all circumstances, "I only want to use a small amount of water every year," and therefore the utility offers it to you at, say, a lower price, but if you exceed it, like when you're using the Internet, you pay a lot higher price, or if you're someone who wants to use a lot of water all the time and you're happy to pay a higher price all the time, then there's that option for you as well, so I guess a bit like phone plans, Internet plans and things like that, those sorts of offerings that actually match people's choices and there's a price that's attached to that.

MR COX (IPART): In principle, there's no reason why that shouldn't be done. I do wonder what the sort of realism of all of this is, just how practical is it to offer different people who are being served from the same infrastructure different levels of service, given the characteristics of water. I wonder how realistic this is. Also, for most of us, water bills are a fairly small component of expenditure and perhaps the gains from these sorts of things may be less than we might expect. There's a question here of complexity versus what actually is the benefit for the consumer. I'm not sure the net benefit has yet been established.

DR CRAIK: I think that's true, but I guess our view is that in recent times, where we've had significant restrictions, there's certainly one section of the community that's been able to be quite satisfied because they think that's an excellent idea, but there's another section of the community that would actually like to use more water and is prepared to pay for more water to use more water, but has been unable to exercise their choice.

MR COX (IPART): Yes. But I guess, thinking about restrictions, there's an issue of social acceptability. Is it all right for me to have bought my way out of water restrictions and be happily watering my garden when my neighbour doesn't do that?

DR CRAIK: You might have a bigger house than the person next door.

MR COX (IPART): Whatever you might think of the desirability of that, I think there's an issue of community acceptance.

DR CRAIK: But do you think that's been engendered by the very substantial information program that governments and utilities have promoted in recent years which has almost said that using a lot of water is unAustralian, whereas we don't say the same thing about petrol heads and things like that.

MR COX (IPART): Maybe, but I also think that when you're in a very severe drought situation, people do appreciate a sense of, "We're all in this together and we've all got to pay our share." I think there's a strong ethic of, "Let's do this together," in the same sort of way.

DR CRAIK: But now we've moved out of that - - -

MR COX (IPART): Yes, there might be scope for greater differentiation when there's plenty of water around but I would then say, well, persuade me that the benefit to consumers is worth the - - -

DR CRAIK: Okay.

DR MUNDY: Jim, you're obviously a bit sceptical about price monitoring but it seems to me at the moment that your organisation essentially sets the tariff sheet for Sydney Water. That's a particularly intrusive form of price control. Have you given any consideration to benefits of falling back onto a revenue basket or a tariff basket. Would you see merit in that approach, particularly if you went down the path of allowing water companies essentially to perhaps offer a suite of products? There may be some people who place a high value on a small, but very secure water entitlement, like people who have got half a dozen fruit trees in the backyard. How would that impact on your ability to deal with the efficiency issues that you talk about, if at all?

MR COX (IPART): Yes. At the moment, we do set an awful lot of separate prices. I do wonder from time to time whether we should be doing all of that. I guess in the past we have been keen in particular on the usage price of water, which we've seen as a very important economic signal. Setting that in relation to the cost of making more water available has been an important issue I think both for the community as a whole and for us at IPART, so I guess that price is one that we have been concerned about. But I think, yes, there is some merit in the suggestion that perhaps the form of the price control could become less intrusive.

We do that, for example, in some other areas. We regulate electricity retail prices on the basis of a weighted average price cap, which leaves the price setting function in the hands of the retailers themselves. I guess we would need to think through what the incentives are for regulating utilities to get the price structure right if they were given freedom to do so, bearing in mind that they may have complex objectives and maximising profits is not their only objective. So, I mean, that's the reservation I would have about it.

DR CRAIK: Just one quick question to finish off, Jim. We proposed a consumer

advocacy body. Do you have any feedback to try to get some more formalised role for consumers in the whole supply augmentation and price setting, tariff and service offering process?

MR COX (IPART): I think there's no doubt that the consumer's voice is under-represented in our hearings, partly for the reason I said earlier: for most of us it's a fairly small component of our overall expenditure. From an IPART point of view, I guess we would have liked the consumer voice to be stronger than it is. I think we do have good relations with various community groups and they help us a lot, but they get into difficulties when the discussion gets technical. For example, you won't get a view on what the parameters of WACC should be. A well-argued consumer view on those sorts of things would be extremely valuable to us, so, yes, I would be supportive of mechanisms to improve the consumer voice, bearing in mind of course that to be effective, they require funding.

DR CRAIK: Thank you. Thanks very much, Jim. Thanks, Scott. Thanks very much for coming along. Thanks for your submission and thanks for answering the questions. Thank you.

DR CRAIK: Next appearing we have Jennifer Bennett and Daryl McGregor from the Centroc and Lower Macquarie Water Utilities Alliance. Thanks very much for coming, Jennifer and Daryl. Perhaps for the record, you could give your names and positions and then if you have a brief opening statement, we'd be happy to hear it. Thank you.

MS BENNETT (C): I'm Jenny Bennett. I'm the executive officer of Central New South Wales Councils.

MR McGREGOR (DLMEC): Daryl McGregor. My role with Centroc and Lower Macquarie is as project manager to both those alliances. Did you want any background on - - -

DR CRAIK: No, that's fine.

MS BENNETT (C): We're assuming that you have some background and have had a bit of a look at our submission, so we probably don't need to repeat much of any of that. I'm here in the role to give you any more advice you'd like to know about Centroc and how it's been working and the general direction of the organisation and anything else we can do to help with questions from your perspective. Daryl has certainly got an enormous amount of experience relating to the running of water utilities in regional New South Wales.

DR CRAIK: Thanks. Just a few clarification issues. I notice Wellington Council is a member of the Lower Macquarie Water and Utilities Association and Centroc.

MS BENNETT (C): Yes.

DR CRAIK: Presumably funds go from the councils to these alliance organisations. So do they pay twice? Is that how it works?

MS BENNETT (C): So Wellington is a paid member of Centroc, and Centroc is a voluntary organisation of councils across Central New South Wales. Regarding the water utilities alliance, we are doing some differing things in two differing alliances and Wellington is part of both of those. The programming to date is based on buy in, buy out, so opt in, opt out. So basically they've done all of their best practice work through the Lower Macquarie Utilities Alliance. Centroc is a little behind the Lower Macquarie Utility Alliance and so we're now engaging in all of those projects, but we are doing other things as well around sharing of information, efficiencies and regional procurement and those types of things which Wellington is engaged in.

MR McGREGOR (DLMEC): Just to further clarify, Madam Chair, Wellington is a participant in the Lower Macquarie Water Utilities Alliance because it draws water

from the Macquarie downstream at Burrendong. It's just by chance that they're also a participant in Centroc, but they're not a buy-in participant of the water utilities of Centroc. They're a buy-in participant of the Lower Macquarie. The original Lower Macquarie Water Utilities Alliance involved the six councils below Burrendong on the Macquarie and expanded to include the more northern outreaches of Bourke and Brewarrina.

DR CRAIK: On the Centroc board, I wasn't quite clear, but you said you had two delegates, the mayor and general manager, who represent the councils. Do they represent all the councils or is there a mayor and a general manager from each council on the board?

MS BENNETT (C): From each council, so it's a board of 34.

DR CRAIK: So it's a board of 34?

MS BENNETT (C): Yes.

DR CRAIK: I wasn't sure.

MS BENNETT (C): We do have an executive as well. The board meets quarterly. You can see from the structure there we also have an executive, but probably more relevantly perhaps is the general manager's advisory committee that tends to run the operational stuff and then we do have a sponsoring GM, which is Parks for the time being, who drive all the infrastructure programming. So there's a lot of governance and support, I suppose you could say, for running our programming.

MR MCGREGOR (DLMEC): But excluding Wellington, there are 16 local water utilities in Centroc and 18 in the Lower Macquarie, so 24 water utilities in regional New South Wales. It represents more than 20 per cent of the state, so, in our view, it's a shining example of the thing that New South Wales water utilities are being criticised for in terms of not embracing reform. This is a shining example of reform by these organisations. But could I just, before we go on, apologise for the two chairs, Councillor Phyllis Miller and Councillor Rex Wilson, who are otherwise engaged, otherwise they would be here.

DR CRAIK: I notice there were nine employees of Centroc. Are they existing council staff who have this as an additional duty or are they?

MS BENNETT (C): No, they're direct employees of Centroc and they do provide some support to the water utilities alliance, but I think the critical thing and the reason this programming is so successful is because it's totally embodied in the councils themselves and so the Utilities Alliance members are the operational staff of

the member councils themselves working collaboratively. So it isn't actually about a higher layer or organisation; we're literally just there to make the wheels turn and support them administratively.

DR CRAIK: So what improvements has all this actually led to?

MS BENNETT (C): Sorry?

DR CRAIK: What improvements in the water systems has all this led to?

MS BENNETT (C): Probably Daryl is a little ahead with the Lower Macquarie Alliance and so I guess from our perspective, the Centroc water security study, for example, has identified what needs to be done to secure water to 2059 in the context of climate change, so that's pretty impressive. As a result of the water security study, we've sort of combined that with the Lower Macquarie model and reviewing the Gellatly report to come up with what the next steps would be. We now know the exact electricity usage - that's one of our programs, for example - of all of our water utilities and we're reducing our costs and introducing power factor correction and those types of things in electricity usage which is a pretty exciting project. I think that's about 200 grand all up across the region which is a useful bit of dough.

We now know the carbon cost of both the water security study and our existing water utilities and we're doing some more work around that at the moment. We're working collaboratively to deliver the best practice things, but I probably should let Daryl speak a little more about that. I've only attended a few of the meetings of the specific operators but those folk, working together collaboratively, are doing some really exciting things, going from water utility to water utility, sharing what they know best in the scouring of drains and things like that. They're quite excitable with each other actually and learning quite a bit from each other, so that's been quite good. I'll let Daryl talk more about where Lower Macquarie has got to because they're probably a little further ahead.

MR McGREGOR (DLMEC): Lower Macquarie was formed in 2008, so it's a little ahead of Centroc. Basically, in terms of your question in what have we achieved, we set out initially to improve best practice across the eight councils and to focus on resource sharing and mentoring and developing training programs throughout the region because as you can appreciate, we've got a very small council in Brewarrina and Bourke, and they have struggled over time. So in terms of best practice, I think we've made substantial ground. We've gone from 63 per cent overall compliance with New South Wales best practice criteria, 63 per cent in 06-07, to pretty close to 90 per cent. I've said in the submission I think about 86 per cent but it's actually improved in recent times and is improving all the time. So our aim is to get 100 per cent compliance with best practice, to focus on water quality and the

treatment aspects of those smaller communities like Brewarrina and Bourke where they do struggle.

Very importantly, we have established supervisor and operator subgroups within the structure and they meet frequently and they visit each other. It's something that may be surprising that they have never done before: they have never had someone to sort of ring up down the road to come and give them a bit of advice and so on, and that's shown tremendous returns to the organisation. We've developed a regional water quality management plan, a regional integrated water cycle management plan, a regional drought management plan, a regional demand management plan, a regional stormwater harvesting strategy, and we're moving more and more into policy development so that everything that they do is governed by a set of criteria that's common to that region. Centroc water utilities are doing exactly the same now, albeit a little bit later. They have just contracted to do regional integrated water cycle management, demand management and drought management. Lower Macquarie and Centroc are combining to do a whole-of-region regional resource sharing, training and mentoring program and that will establish standards for all our operators across those 24 water utilities.

DR MUNDY: Can I just bring you back to Bourke and Brewarrina which have substantial indigenous communities and populations. Were there issues about the quality of particularly indigenous community water supply around those towns and has it improved as a result of the alliance?

MR McGREGOR (DLMEC): Water quality has improved. Some of the data that's been published elsewhere indicates that Bourke has had bore water alerts and so on for a period of time. It is an issue, but those bore water alerts are for some of those regional towns that are not supplied with a potable supply. They have got rainwater tanks and they're supplied with the raw water, but for obvious reasons, the council has decided to issue an advisory bore water alert just to encourage people not to use it but it shows up in the stats as bore water alerts.

Brewarrina hasn't had bore water alerts and their water quality is not too bad. Their water treatment plant is ageing and needs serious capital investment but, more seriously, their sewage treatment works is a worry to us and that's a challenge for these alliances as to work out how to fund those sort of works with a diminishing subsidy and grant arrangement applying. As you will see in the submission, we've been a bit coy about subsidies and so on; we see, as two alliances, the need to look after some of those smaller communities who are somewhat disadvantaged, as you know.

DR MUNDY: Does that support come by way of one council who has got a senior engineer lending a bit of a hand, going out and helping, or does it go beyond that to

some sort of financial assistance?

MR McGREGOR (DLMEC): There's been no financial assistance.

MS BENNETT (C): There's a little bit in Centroc. Our larger councils have been funding - I suppose it's the same thing with Lower Macquarie, where the larger councils are offering a greater contribution. So, for example, we're doing some further strategic work to progress our water security project infrastructure component - - -

DR MUNDY: So some of the common costs - the bigger councils will carry more of the burden of the funding of your organisation proportionally than perhaps the smaller - - -

MR McGREGOR (DLMEC): But not for capital works.

DR MUNDY: Yes, they've still got to do that.

MR McGREGOR (DLMEC): For the regional strategies and so on, yes, say, in Lower Macquarie, Dubbo being the centre of the universe out there contributes 60 per cent of the total cost. That's a great credit to Dubbo, to take on that leadership role. But in terms of the sort of improvements that we're seeing, the standard of operator, say, at Brewarrina and the training was not good. We've been able to improve that dramatically through that operators' group.

DR MUNDY: So really what your organisations are doing is addressing these people based technical skills concerns that small councils just simply can't get at by themselves, rather than integration of systems and linking up the bits of the water system.

MR McGREGOR (DLMEC): Yes. Currently at Lower Macquarie we're just about to get a team of specialists to go round to those places and spend a week with the operators to work out exactly what can be improved and what's being done incorrectly and to specifically train them up to the required standard. So we're aware of those sorts of issues and I don't know of any other way that you could get a level 4 operator to go and live and work in Brewarrina.

DR CRAIK: Does this add to the whole cost of the water businesses in every one of these places? I'm not saying there aren't benefits, but just - - -

MR McGREGOR (DLMEC): The cost of the water businesses in places like Brewarrina by necessity will have to go up and in fact under their strategic business planning and for a lot of them - for example, Bogan shire - the strategic business plan

indicated that they needed to increase their residential bill for water supply by 75 per cent. Guess what? They did.

DR CRAIK: Does that mean that the costs for all the water businesses in these alliances have gone up?

MR McGREGOR (DLMEC): No, not necessarily. Some of them will because some of them have fallen a bit behind over the years in terms of - so that sort of advice on pricing policy and those strategic business plans which some of them haven't had is now giving them the mechanisms to go forward with a true understanding, rather than the traditional sort of local government approach of, "No, let's not put the rates or the charges up."

DR CRAIK: I was really asking the cost of actually running the alliance and the things that the alliance does, that Centroc does, the contributions to that, does that mean that the costs of the water businesses have gone up?

MS BENNETT (C): Yes.

DR CRAIK: Obviously that has to be reflected in the prices in each of the - - -

MS BENNETT (C): Yes, but at the same time - - -

DR CRAIK: I'm not saying there's no benefits, I'm just - - -

MS BENNETT (C): In fact I think at the moment it's cheaper for councils to be part of the alliance because the best practice work, when undertaken on a council-by-council basis, is significantly more expensive than doing it collectively by a factor of quite a large amount. So the councils are very excited to be working on these projects collaboratively.

DR CRAIK: Is there documentation of that?

MS BENNETT (C): We can certainly get it to you.

DR MUNDY: If you could send us some data on that, that would be helpful.

DR CRAIK: That would be really useful, yes.

MR McGREGOR (DLMEC): So it's quite good because not only is it so much more inexpensive, but also by doing it collectively, they're learning so much more and gaining so much more out of it, so it's a total win-win for our - - -

DR CRAIK: If we could get something on the costs of benefits of this process, that would be really very useful.

DR MUNDY: Can I just bring you back to these regional plans that you were talking about. I just want to clarify. Your members, you mentioned they were on the Macquarie below Burrendong. So they have some commonality that they share a water resource. So there's all this activity going on that both organisations are doing with respect to small councils and training and people, but there's this other stuff that's going on presumably about taking water out of that resource. Do you work on those issues together as well or is that something which individual councils just deal with their allocations and away they go?

MS BENNETT (C): I can speak to Centroc with the water security study that we did, and that actually identifies across LGA boundary solutions, both infrastructure and non-infrastructure solutions. We're going into the next stage of that on a risk-based approach and so we're actually identifying the best business and governance arrangements and the licensing arrangements and those types of things to be doing dam augmentation and running a network of pipes. So it is a very significant project to secure water to 2059 for all the communities in central New South Wales.

DR MUNDY: Given what the current state of your work is, are there any obstructions to that from a legislative or regulatory and administrative - - -

MS BENNETT (C): We're just going through that process at the moment. We've certainly been watching very carefully what has been happening with the Macquarie pipeline emergency project out of Orange at the moment and watching what they're experiencing in terms of licensing and those types of things, and it certainly is a significant series of hurdles, but the way we've decided to best tackle that is to set up a taskforce actually engaging state agencies and a couple of federal agencies as well, having them all in the room at the same time and so we actually take it forward and that taskforce which has been modelled on the Macquarie pipeline was actually put together between the federal and state government under the premier's department, and so we're hoping to use to a similar model along those lines and so actually have all the people in the room working together and having some ownership over it and hopefully not perhaps taking as bureaucratic an approach as sometimes happens when you've got one department talking to another department, but not together at the same time.

MR MCGREGOR (DLMEC): I think the biggest constraint to these sorts of projects is capital cost. The cost of some of these sorts of initiatives are way beyond the capacity of even the whole alliance, I believe, and there needs to be substantial government grants to cover them. But just to hark back to the sorts of things that

we've done in terms of managing those things: the integrated water cycle management plan embraces those sorts of demand management analyses, the capacity of the source. The Macquarie below Burrendong is quite a secure source. The Darling up around Bourke and Warren is quite a secure source. I think it's important to differentiate between the expectations of metropolitan communities and the expectations of the rural communities. They're quite resilient, as you probably know, and they're quite well adapted to dealing with drought over time, so the question of water restrictions and so on is not really an issue in those places. It's readily accepted. I believe that that is somewhat different in metropolitan areas, but I think that's an important distinction.

But just harking back, those studies have been done, we've looked at those sorts of security issues. We've looked at what needs to happen over the next 30 years. We're talking about communities, apart from, say, in the Lower Macquarie. Dubbo is probably the shining example of growth. But you're talking about negative growth in some of them and zero growth in others, so there's not those population growth constraints that apply in the metropolitan areas as well. So I think there needs to be that sort of separation in these sorts of discussions and debates about reform and about delivery of service.

DR CRAIK: The issue of cost recovery. In your submission you state that the economic real rate of return is a useful benchmarking comparator, but you would also support a benchmark that reflects full economic cost. So I guess the question would be what do you think the appropriate measure of a benchmark is.

MR McGREGOR (DLMEC): Personally - and this is not a statement from either alliance - but I think the full economic cost is the way forward. Economic real rate of return can be a variable and doesn't really give these sorts of organisations the right sort of information to go forward, I don't think.

DR MUNDY: Can you just flesh that out a bit. Where does it fall down?

MR McGREGOR (DLMEC): I don't think they understand, to be honest. For regional water utilities to manage their finances, they tend to look at it in the short term, and that's what we're trying to address: the longer term, the 30-year financial planning and so on. But they tend to look at what their operational and management and administrative costs are and what impact that will have in terms of charges to their constituents and customers. So that sort of economic debate needs to be fleshed out for them in terms of what are the real drivers and what needs to happen going forward, and that is a fairly difficult task with some of the smaller ones, I think.

DR CRAIK: Do you have a view about what a sufficient rate of return would be for a local water utility to have enough - - -

MR McGREGOR (DLMEC): As an economic real rate of return, I think it's got to be more than .5.

DR CRAIK: Would roughly 5 to 7 per cent be in the ballpark?

MR McGREGOR (DLMEC): Yes. It depends on the size of the community and its general capacity and its affordability and its capacity to pay. That really can't be always measured in economic rates of return, I don't think, for those communities. I'd be happy to hear your views on that.

DR CRAIK: We've got them in the report. But a number of the counsel utilities in the alliance are low or negative economic real rates of return.

MR McGREGOR (DLMEC): That is an issue and an area that we're working on through that strategic business planning and financial management process.

DR CRAIK: Looking forward for security of supply issues, yes.

MS BENNETT (C): Bathurst actually did some modelling based around if they had to pay a dividend back to some parent-type organisation and should government's arrangements or structural arrangements change. Based on their modelling, they were looking at their communities paying around 30 per cent more for water charges and they found that a little bit shocking. So I guess the position of the Centroc board is that communities should be able to cut the cost, to some extent for what sort of level of service they're looking at.

DR MUNDY: I guess the question it begs in my mind is that even if you put aside the fact that you mightn't be paying dividends, you've still got to service debt.

DR CRAIK: Yes.

DR MUNDY: So I would have thought that my inclination on it, putting aside all the capital market theory issues, would have been that something like the cost of debt would have been where you were starting, because otherwise some other part of the council's activities is servicing the debt. Is that - - -

MR McGREGOR (DLMEC): That's what we do with the financial planning, which has got a 30-year time frame, is to work out what capital works are required over that 30 years. That, with some of these communities, is crystal ball gazing, because if they've got negative to slightly positive growth, they're excited and to establish a price path that says what the typical residential bill has to be to meet all those commitments, including if they need to borrow funds. That's the driver and

going back to the Bogan strategic business plan, that's what that financial modelling told them, is to service their costs over that 30-year period, they needed to increase their typical residential bills by 75 per cent.

DR MUNDY: So what do you do with the existing assets then? There is a certain amount of debt that councils have attributed to their water businesses already, so therefore they just keep trying to recover that debt.

MR McGREGOR (DLMEC): They need to service all debt and all operation and management costs over that period. So the price path gives them that information and then they review that every five years in terms of what may have happened within their communities in terms of population growth or other changes. So that financial management process and the strategic business planning takes account of the depreciation and the age of those assets and the forward capital works program over 30 years takes account of replacing and refurbishing those assets. Often it's not a case of augmentation because there's no growth.

DR CRAIK: To the extent that some smaller councils are unlikely to have the werewithal to put up the prices, I assume to the extent to maintain the sort of standards that might be desired or required, is there any kind of process in place to try and get government assistance in some kind of community - - -

MR McGREGOR (DLMEC): Certainly Brewarrina gets - - -

DR CRAIK: - - - CSOs or subsidies or something like that? Is there something?

MR McGREGOR (DLMEC): Yes, Brewarrina, for example, the three major customers are land councils. They sometimes find it difficult to pay. Their dilemma is they get that money through state funding eventually but it can be 12 months in arrears, so cash flow can be a bit of a problem. We shouldn't dwell on the smaller ones to any great extent because quite frankly they're doing a fantastic job with what they've got.

DR MUNDY: Except that if we dwell on them slightly, we might be able to - - -

DR CRAIK: Fix them up.

DR MUNDY: - - - look at arrangements that will help them out.

MR McGREGOR (DLMEC): True. That's what we're trying to do, with all respect, commissioner.

DR CRAIK: We're trying to raise the issue and shed some light on it, I suppose.

MR McGREGOR (DLMEC): Yes.

DR MUNDY: We've become aware that there's a bit of controversy about some work that was done for Infrastructure Australia.

MS BENNETT (C): Really?

DR MUNDY: It shows we read everything that's sent to us. There's a mountain of paper on this and I think we understand the issues. I guess my question is - and it seems that your sorts of organisations and your constituent members have communicated with IA around about the end of March - have you received any response from IA with respect to the correspondence sent to - - -

MS BENNETT (C): Not that I can recall, but if I could take that on notice, I'd prefer to go back and check because we get a lot of correspondence, but not that I can recall.

DR MUNDY: I guess the other thing I'd be interested in is were you expecting a response or is this just part of the process of, "Send it in and see how it goes"?

MR McGREGOR (DLMEC): I think what the two alliances - and speaking out of turn again - were seeking was some sort of consultation which appears to have been totally missing, and that's a credit to this commission, that we've had an opportunity at the front end and now again to talk about things. We see that that's had some benefit in the differences between the reports.

DR CRAIK: Did they not consult at the first round?

MR McGREGOR (DLMEC): I beg your pardon?

DR CRAIK: Did they not consult before they put their first report together?

MR McGREGOR (DLMEC): They did consult - I'd have to take advice on that - with the water directorate but I understand that that advice was largely ignored and in fact sometimes quoted incorrectly and out of context, but I wasn't party to that, so I'm speaking second-hand.

DR MUNDY: But you weren't consulted?

MR McGREGOR (DLMEC): I beg your pardon?

DR MUNDY: Your organisation wasn't consulted?

MR McGREGOR (DLMEC): No.

DR CRAIK: Nor the New South Wales Water Directorate.

DR MUNDY: Was Centroc consulted?

MS BENNETT (C): No, I'm just trying to think of - - -

DR MUNDY: Let us know.

DR CRAIK: Yes, take it on notice.

MS BENNETT (C): Yes, I'll take it on notice.

DR CRAIK: That would be useful. Just a final question: you've mentioned working towards the development of a set of pricing principles. Can you give us some idea of what the pricing principles might be and what sort of guidance - - -

MR McGREGOR (DLMEC): It's difficult, but what we want to have is a set of principles and guidelines so that everybody is pricing their services on exactly the same basis. The first stage of that is to get these business planning processes completed, to get the financial management planning processes completed so that we know what we're dealing with. We won't have postage stamp pricing, I don't believe, across the region because each of them has got their own separate sources and treatment processes and so on. But we want to be confident that each of the 24 water utilities are actually working on the same basis, the same equations, and that there is some comparison across them in terms of equity for their customers. If it transpires that one water utility is charging twice as much as the other down the road, then we would want to look very closely at that. We want a level playing field and some consistency, so that the customers of the 24 water utilities have got a good understanding that they're being treated fairly.

DR CRAIK: Okay. Just one final question: did it require any legislative change for you guys to set up these alliances? Did the New South Wales government have to change any legislation to enable you to - - -

MS BENNETT (C): No.

DR CRAIK: Just all totally voluntary?

MS BENNETT (C): No, although there is some discussion now at the state level about what sort of legislation could come in to support the activities of collaborative

arrangements, just around things like - for example, procurement is one area that would be a lot less challenging for us because as you can imagine with all those councils working together, the dollars get very big and you start to jag the Local Government Act stuff, around tendering and those types of things. It would be handy if we could get, for example, prescription from the states similar to, say, state contracts or local government procurement or something along those lines.

DR MUNDY: So yourself and your seven staff, the entity that employs you, what's its legal form?

MS BENNETT (C): It's a section 355 committee under the Local Government Act of Forbes Shire Council.

MR McGREGOR (DLMEC): That's the way the water utilities have been established as well. It's been a source of frustration for these councils because the Armstrong-Gellatly report was published in 2008 and there's been no direction from state government, so these councils by their own volition have taken matters into their own hands. They've formed these organisations under section 355 by deed of agreement signed by mayors and general managers at each of the councils.

DR MUNDY: Does Armstrong and Gellatly suggest institutional arrangements that might be more supportive of what you're - - -

MR McGREGOR (DLMEC): They were leaning towards more binding alliances and we've taken legal advice on that at Lower Macquarie. The deed of agreement is being adjusted to, we believe, satisfy that issue.

DR CRAIK: A more binding alliance issue - - -

DR MUNDY: But there's potentially an easier legal form available, you would have thought?

MR McGREGOR (DLMEC): Yes. The way we're operating, we think it's a good legal thing.

DR CRAIK: Okay. We should finish now. Thank you very much. That's very helpful. If you could send us that information - - -

MS BENNETT (C): We will. There are two items, I will just check, the best practice program, savings - - -

DR CRAIK: Costs and benefits, I suppose, that would be great.

MS BENNETT (C): Okay. I'll just check on the response from IA.

DR CRAIK: Yes, that would be fantastic. Thanks very much. We will now break for morning tea and we will resume at 11 o'clock with the New South Wales Water Directorate.

DR CRAIK: Thank you, everybody. Now we have the New South Wales Water Directorate so I would ask you to state your name and position and if you'd like to make a brief opening statement, we would like to hear from you. Thank you.

MR McLEOD (NSWWD): Thank you, Madam Chairman. Stewart McLeod, I'm the chairman of the New South Wales Local Government Water Directorate. The water directorate is a membership based organisation, has 95 local water utilities members of it. They pay a fee to be part of the water directorate. We have one and a half full-time staff. The governance is through an executive committee of which I'm the chair. We formed in 1998 after there was a change of government, and the old Public Works Department which used to look after local water utilities, if you like, ceased to exist, so we needed to come into being to be an advocacy body and we've also published quite a long list of technical guidelines and booklets since then. We work in close collaboration with the New South Wales Office of Water but we find that we need to publish a lot of technical stuff now that used to be done for us by the state government.

In terms of the Productivity Commission report, we are very broadly supportive of it. The details of that support are in our submission. One of the main issues we have is obviously the inaccuracies that we see in the Infrastructure Australia report that was done for them by AECOM, a lot of rather alarmist, sensationalist-type information in it that we disagree with. We support the general findings of the Armstrong-Gellatly report that the New South Wales reform process needs to come to some finality and we're in full agreement with the one size not fitting all option, particularly in the west of the state. I think there needs to be things like alliances or county councils or some sort of aggregation, but not going down the regional corporation route. You have no doubt read the submissions, so I guess I'm happy to start taking questions.

DR CRAIK: Okay, thanks. Can I just start with the full cost recovery one; we've been discussing it with some of the other people here this morning and I guess I'm curious to hear your views or the directorate's views on the New South Wales Office of Water approach to measuring full cost recovery.

MR McLEOD (NSWWD): I think at the moment, economic real rate of return demonstrates that if that's positive, then you're charging enough - I mean, provided you've been doing strategic business planning as, in theory, we have since 1993 - to cover operations, future capital works which is both new works and rehabilitation works. The Office of Water recommends that a local water utility should pay a dividend to its hosting council but there are caveats on that. You must have got 100 per cent compliance with best practice before you can do that. There's only three councils at the moment that choose to pay a dividend. I guess local water utilities

have never been told that they shall have an economic real rate of return of 5 or 7 or whatever, so provided it's been positive, most water utilities have just been doing what they believe was the right thing, covering their costs.

DR CRAIK: Do you think they should get a guideline of 5 or 7 or the sorts of numbers that have been suggested this morning as the sort of number that's needed to actually ensure general cost recovery over the life of the - - -

MR McLEOD (NSWWD): No, there is cost recovery; it's whether the hosting council gets a dividend that they could perhaps spend on other functions like roads or libraries.

DR CRAIK: But do you think under the current arrangements, it's sufficient to ensure that there's enough ability to maintain and renew and add to assets as required?

MR McLEOD (NSWWD): Yes, sure. If you've got a positive real rate of return - - -

DR CRAIK: I guess I was talking about the fact that quite a few don't have a positive - have a negative or zero. A number have a zero or negative real rate of return.

MR McLEOD (NSWWD): As far as I knew, there was only five utilities in 08-09 that didn't achieve full cost recovery and that's out of 103, so - - -

DR MUNDY: But there's a two-part test, isn't there, about full cost recovery? If you've got a positive rate of return, you're through the gate, and if you've got a negative rate of return, you can go and have a discussion at the Office of Water about your business plan going forward, then you might get through the trap.

DR CRAIK: If you're going to put up the price next year.

DR MUNDY: If you're going to put the prices up next year, then maybe you'll be forgiven your sins.

MR McLEOD (NSWWD): I'm not sure of that detail.

DR CRAIK: Fine. That's what it says in the report.

MR McLEOD (NSWWD): I think that is the process.

DR MUNDY: So really the notion of full cost recovery has a degree of

administrative arbitrariness to it.

MR McLEOD (NSWWD): It does.

DR MUNDY: Coming back to these questions of rates of return, you've got a positive rate of return which means you're covering your depreciation costs and you've got something left. The cash then presumably is held within the water business?

MR McLEOD (NSWWD): Yes.

DR MUNDY: It's there, so it's presumably used for purposes - it goes into a sinking fund, presumably, or something along those lines?

MR McLEOD (NSWWD): Yes, which would be for both renewals and new infrastructure.

DR MUNDY: And for paying the interest payments on the debt currently incurred?

MR McLEOD (NSWWD): Yes.

DR MUNDY: This is always a fraught question: how far back - and this is just a general question, but obviously some assets have been in the possession of councils since they were established, particularly, say, in the form of land, dams and those sorts of things - do you ascribe an asset value to those or do you really just recover the depreciation costs?

MR McLEOD (NSWWD): In New South Wales we have to do fair valuation under the Local Government Act, so the cost of producing those assets now is the fair value of it.

DR MUNDY: And you earn a return on that fair value? I guess I'm getting to the question of how is that fair value financed or does it come into consideration?

MR McLEOD (NSWWD): It's part of depreciation, isn't it?

DR MUNDY: Land doesn't depreciate.

MR McGREGOR (NSWWD): It is accounted for in that way. If it appreciates, then that's part of the overall net asset base.

DR MUNDY: But if it's a long-term durable asset like land or something that has the characteristic of land, then effectively it just sits there and no return on it.

MR McGREGOR (NSWWD): Yes. It's also important I think to state that most water utilities try and build up their reserves out of those profits per annum to fund future capital works. So if you look around the state, in terms of how much is held in trust, if you like, in reserves, it is an attractive bucket of money for anybody with an eye to it, if I can say that, including councils.

DR MUNDY: I was about to suggest someone in Macquarie Street.

DR CRAIK: In the submission you suggest that the adaptive management approach that we have proposed for water supply planning and supply augmentation is typically utilised by local water utilities in determining their costs and benefits. Can you give us some indication as to how the local water utilities do that sort of adaptive planning approach?

MR McGREGOR (NSWWD): My definition of adaptive management is moving with the requirements of the organisation and the customers and I think that's a given for pretty well most of the water utilities in New South Wales, certainly the larger ones, and it involves that sort of forward planning and embracing of innovation and so on as required. It varies across each of the organisations.

DR CRAIK: One of the things we were thinking about was the notion that for the future there's a possibility under various scenarios that we might start to run out of water, so you start to put a number of things in place. You might say, "Well, we might have to drill a bore and desalinate that water before we can use it, so we should get all the permits in place for the bore but we don't need to exercise anything until such time," but that's a sunk cost that you might not end up needing because it might rain and fill up the dams. I guess I'm saying do councils go through that sort of process - - -

MR McGREGOR (NSWWD): Certainly.

DR CRAIK: I'd like an example if you can of how local water utilities do that.

MR McGREGOR (NSWWD): The processes that are in place in terms of that sort of adaptive management are embraced in the integrated water cycle management process that identifies the needs, identifies the options going forward, and then that translates into the strategic business planning approach - "When the council says yes, this is what we are going to do over that time frame," which is typically 30 years and can be down to 20 and sometimes even longer - and that's their guiding map. As part of that adaptive process, that map is reviewed, in the case of strategic business plans, every three years or every six years.

DR CRAIK: Do you get situations where you end up having spent money and because something changes - - -

MR McLEOD (NSWWD): At the moment, Bourke's drought security needs to be a bore, which is being constructed 10 kilometres out of town. So they have actually constructed the bore, but then it rained. They know that they still need to fund the pipeline to get the water back to town and instead of having to do that as a relatively emergency job, they now know hopefully with the next drought - you know, it might be five years - they have time now to plan the funding and the construction of that pipeline. Dubbo is in a similar boat. Our drought security under a climate change scenario says that we should really be looking for another significant source of water by about 2025. So we have done the necessary studies to find out where three new bore fields could go and we have put in our forward strategic business plan that in about 2015, 16, we need to start making that happen. That's a typical example of adaptive management.

DR CRAIK: Yes, that's great. Thank you.

MR McGREGOR (NSWWD): It can be difficult for places, for example, like Cobar. You look at Bogan, Brewarrina and Bourke and they are not growing at all, but Cobar is because of the mines. That could change within a short period of time, so they have to embrace that sort of potential change. They're not likely to do anything, apart from secure supply which involves the Albert Priest channel, and there will be some issues with the funding of that. But in terms of major capital works, they really shouldn't be looking at anything more than, say, a 10-year turnaround because things can change so dramatically. One of the problems that I see across the state is that in the past, things have been built for positive growth when it didn't occur, so there are a number of water utilities across New South Wales that have got large sewage treatment works that will never reach full capacity, so that's an issue for them and sometimes there's a need to decommission some of these works. That's not a generalist statement but there are issues of that. So planning for what may occur, in terms of population, is critical and is difficult because it can go from zero to negative to slightly positive in a lot of these places.

DR CRAIK: Yes. That's good, thanks.

DR MUNDY: You provided us with a copy of your response to the AECOM report as a submission which is on our web site and it raises issues which a number of your members of Centroc and others have raised. I asked one of you this question before morning tea: have you received a response to your submission?

MR McLEOD (NSWWD): Only an acknowledgment letter.

DR MUNDY: Okay. Do you have a sense of what the process is going forward from here?

MR McLEOD (NSWWD): No.

DR MUNDY: Are you expecting one?

MR McLEOD (NSWWD): We're not sure. It would be good to get a response. The National Water Commission I know, for example, is making noises now about wanting to meet with the industry and that's a good approach. I'd recommend that Infrastructure Australia do a similar process.

DR MUNDY: Consultation on infrastructure is important. In that response, you were concerned about regionally owned corporations stripping local communities to pay a dividend and you've indicated there are very few local authorities who at the moment pay dividends to their shareholding councils. So I guess my question is if that structure proposed in the AECOM report were to arise, where would they find the cash to do that? Would they find it through efficiencies, gouging customers or reducing services, do you think, because the cash must come from somewhere which isn't currently delivered, otherwise more of your members would be paying dividends.

MR McLEOD (NSWWD): I would presume they would have to put the prices up. We're pretty efficient now. Local governments always run on the smell of an oily rag, as they say. So we don't see huge efficiency gains being available. So the only way that dividends could be paid, in our view, is that prices would have to go up.

DR MUNDY: What if such a corporation was owned by the councils, a bit like the Tasmanian circumstance, for example. Would that propose less risk to this dividend stripping?

MR McLEOD (NSWWD): It certainly would propose less risk, yes. But, again, it would need to be corporations that the local water utilities in that area were comfortable with that approach. If it was imposed, it wouldn't be much better than if it was a state-owned corporation. The important thing is that what is sensible and suitable for each area needs to be determined by each area and the structure adopted by them.

DR MUNDY: I guess following on that, I think you made an observation at the start about the alliance and framework working reasonably well in western New South Wales. We'll hear a little bit later from MidCoast Water, but clearly there are other parts of the state where alternative arrangements have been adopted and both seem to be achieving good outcomes for the communities that they serve. Given

your pretty much whole of state brief, have you got any insights into why one isn't working in one place and why one is working in the other and is there something that underpins that that provides a guide to where you might try a certain thing? Is it the geography? Is it the concentration of population? Is it the availability of the water resources?

MR McLEOD (NSWWD): It's probably just history at the moment. The water directorate has four county councils as members. There are five county councils in the state. We're fully supportive of county councils. If a local group of councils wanted to form a county council as their method of delivery, we would be perfectly supportive of that. There is up on the north coast the seven councils up there. In that map of New South Wales there, you've got three big alliances out west, but there is that NOROC group, who are preferring to go down the alliance group at this stage. MidCoast does a good job for the member councils that are part of MidCoast. I think it's more historic as to whether someone prefers a county council or an alliance or a corporation.

DR MUNDY: So the real benefit is that they are getting together and doing it.

MR McLEOD (NSWWD): The real benefit comes from getting together, yes.

DR CRAIK: Did any of these county councils evolve from alliances or anything like that or did they just go from - - -

MR McLEOD (NSWWD): No. Alliances are a relatively new animal. They really arose in 2007 as a potential response to the New South Wales reform process, but county councils in New South Wales have been around forever, not just doing water and sewerage; they do weeds and libraries and things. So I think it is just a matter of history as to how a particular area decided to get together.

DR CRAIK: Do the councils that previously used to deliver most water services, do they suffer from the loss of the water and sewerage services that go to the county council?

MR McLEOD (NSWWD): I couldn't really comment on that because I've had no personal experience of it. Anecdotally you hear councils complaining about their county council, but I think it's human nature to complain about whatever the status quo is. People will complain about it.

DR CRAIK: That's true.

MR McLEOD (NSWWD): I wouldn't like to say that as a general rule, member councils are dissatisfied. I wouldn't like to say as a general rule they're all fully

satisfied either.

MR McGREGOR (DLMEC): From my perspective, there's a big difference between the coastal councils and the inland councils, in that the coastal councils are generally growing at a fairly rapid rate and they're large, whereas inland they're not, they're typically small.

DR CRAIK: With the exception of maybe the Dubbos and the - - -

MR McGREGOR (DLMEC): The Dubbos. There are hubs out there. That's where these alliances need to be set up. But I think a factor that is being overlooked by a lot, and not by this commission, is the interdependency of the water utility aspects of the councils out in those areas and the council itself and I think the water director has worked out that for those councils, it's something like 30 per cent of their business. So if there are going to be large-scale reform which involves taking water utilities from those councils, then that can't be done in isolation to something being done in the councils. If you look back on the Kennett process in Victoria, that was exactly what happened.

DR CRAIK: Yes, they were done together. That's right.

MR McGREGOR (DLMEC): Plus some hundreds of millions of dollars.

DR MUNDY: This is an entirely open question. Is it the case that coastal councils tend to be a bit bigger and a bit financially more robust.

MR McGREGOR (DLMEC): Yes. I think a lot of them are big enough to run separate businesses and they've got the opportunity, say, for water businesses to form alliances or corporations that are separate from the council activities. I think for some of them - and I can't really speak for them - but I think it's probably advantageous for them to do that. But the other thing to take into account is that stormwater is a function of local government. If we're going to be serious about water management, then that also has to be looked at and resolved in some way, otherwise it becomes awfully difficult to get this integration of that water cycle.

DR CRAIK: So has the stormwater not gone to county councils?

MR McGREGOR (DLMEC): No.

DR CRAIK: The stormwater is still with the local government, but the water - - -

MR McGREGOR (DLMEC): Yes, it's a local government function. I think it is Victoria as well, even now.

DR CRAIK: I think you're right.

MR McGREGOR (DLMEC): It's a problem for them because they're dealing with the same thing.

DR MUNDY: Is there any statutory reason why, if a council was going down the path of joining in with a county council, is there any statutory reason - I understand all the issues about drains being attached to roads and road engineers wanting to keep the drains - but is there any statutory obstruction for a local council about to join a county council saying, "We'll take the drainage as well once it leaves the kerb"? Is there any - - -

MR McGREGOR (DLMEC): Pass on that. I don't know.

DR MUNDY: I accept there are all sorts of engineering reasons why you want - - -

MR McGREGOR (DLMEC): I don't believe that it's cast in legislation. I don't know. But - - -

DR CRAIK: Does it create difficulties having the stormwater with the local council and the water with the - - -

MR McLEOD (NSWWD): I'm not sure on that. I'm sure Neil from MidCoast can - - -

DR CRAIK: We'll ask Neil.

MR McLEOD (NSWWD): Not having experienced it, I don't know.

MR McGREGOR (DLMEC): It does make that integrated water cycle aspect more difficult, but not impossible. Metropolitan councils deal with it. But I guess they've got the sort of mass of staff and so on to be able to manage that and they can form those sorts of interdependent committees that manage their water-sensitive urban design and so on.

MR McLEOD (NSWWD): Whilst four of our members are county councils, obviously 91 are general purpose councils and for them, having water and sewerage within the broader framework of the local council, it certainly makes integrated water cycle easier, it makes strategic land use planning easier, because one director is just dealing with the other director in the same room as to where is the most efficient place to put water in a sewer, where is the town going to grow to in the next 10 years. Land use development control is certainly a lot easier when you're dealing with an

internal relationship between the water and sewer provider. Council's parks and reserves tend to be a major water user.

I know at my council at Dubbo I've been able to put pressure on the parks director to use less water and he's responded by using 40 per cent less water than he was five years ago, so you've got that close control. A lot of municipal uses are major water uses, like the pools and airports and depots. So when you've got that close control, you've got advantages there. The water and sewerage billing is all integrated. You've only got the one database of customers essentially and if you're trying to get a water conservation message out there, people tend to probably identify with the council brand, so you get that water conservation message out. I don't want to overstate them, but there are some great advantages from being integrated, rather than disintegrated.

MR McGREGOR (DLMEC): There is an issue with most of the county councils, I believe, in that they provide water supply and each of their constituent councils manages the sewerage fund and then independently through the council general fund manages stormwater. They've coped with that and managed with it and I think you'll see from the submissions to the Armstrong-Gellatly report, that they're comfortable with that. But it seems to me that that's an area that needs to be looked at seriously.

DR CRAIK: Would you suggest the sewerage needs to go with the water?

MR McGREGOR (DLMEC): I think it makes a lot of sense in terms of cost efficiencies and operational aspects. Small utilities that have to have a sewer crew specifically for that and maybe to do some storm water or the like, if they had some of the water function or were able to transfer the sewer function to the county council, I think there could be some efficiency gains there.

MR McLEOD (NSWWD): Most councils in recent times have found that they needed to put the water and sewer fund operations together. I think 20 years ago it was probably fairly common to have a water fund and a sewer fund and some sewer employees and some water employees, but I think more and more round the state you'd find that local water utilities have combined functional groups and they not only get economies of scale out of that, but in these days of confined space entry, you've really got to send three people to a site. In the old days, a sewer fund might have only had two employees in a small council.

MR McGREGOR (DLMEC): Water people can get the thrill and excitement of working in sewerage.

DR CRAIK: Yes, I'm sure. Let's move onto another subject

MR McLEOD (NSWWD): It's our bread and butter.

DR CRAIK: Your comment in your submission that water restrictions are only applied during droughts or emergencies. Just a question: is there scope to use prices more, rather than restrictions, in dealing with water availability during a drought?

MR McLEOD (NSWWD): It's a very slow instrument. It's a delayed instrument. You only send bills out ever quarter. They're in arrears. The reservoirs have run dry by the time you send the bill out which might do the trick. I don't think pricing, at least in a country town anyway, I don't think the response is quick enough for that to work.

DR CRAIK: How long before you need restrictions do you kind of identify that you're likely to need them?

MR McLEOD (NSWWD): You have triggers in your demand management plan and your - - -

DR CRAIK: Based on the dam level or based on the reservoir levels or something.

MR McLEOD (NSWWD): Or whatever is relevant.

DR CRAIK: Could you apply the same logic though to prices? You've got triggers for restrictions, so instead of restrictions, you - - -

MR McLEOD (NSWWD): It would be a minority in the community who would be proactive enough to realise that, "The bill I'm going to get in three months' time is going to be higher." The majority of people wouldn't respond, I don't think, that quickly. They need something that is a lot more definite, a lot more immediate, which is where the imposition of restrictions has its advantage, because restrictions happen as of tomorrow morning. The fact that the increased price happens tomorrow morning - - -

DR CRAIK: Doesn't register in the same way.

MR McLEOD (NSWWD): - - - doesn't register.

MR McGREGOR (DLMEC): I think it's the basic distinction between demand management and drought management. You only introduce restrictions when you have to. Pricing is a good demand management tool, but it's the old sore tooth. You put the prices up, consumption goes down, but then it creeps back up when they realise it's still a lot cheaper than the phone bill. So it's an ongoing process. But it's used mostly in New South Wales pricing as a demand management tool, as well as

the normal function of pricing to cover all your operation, maintenance and administrative costs. But, in my experience, the most effective way of controlling demand - - -

DR CRAIK: Is restrictions. Okay.

MR McGREGOR (DLMEC): Restrictions, they're the last resort, only when you absolutely have to. But a lot of councils would like to have the opportunity to have a level 1 restriction in place all the time, which is, under the rules, not allowed at the moment.

DR CRAIK: We should probably finish up. I didn't realise we had been going so long. Thank you both, Stewart and Daryl. Thanks very much for your submission.

DR CRAIK: Could now we have Neil Hanington from MidCoast Water. Thanks so much, Neil. Thanks for coming along. Thanks for your submission. If you'd like to state your name and position for the record. If you would like to make a brief opening statement.

MR HANINGTON (MW): Neil Hanington, general manager, MidCoast Water. MidCoast Water is situated at Taree on the mid-north coast. We have 38,000 customers. We cover some 7000 square kilometres and two local government areas, but it will be three from 1 July. Even though we have a lot of customers, we have less than the state average of customers per kilometre of both water and sewer main. My background is that I've been in the industry 46 years and I've served on two committees. One was a recent National Water Commission committee. I was one of the fortunate ones to be invited to make comments. Also on the Barton Group, which was in about 2002, 2003, MidCoast water was the only regional authority in Australia that was invited to join the Barton Group for their discussions on the value of industrial water throughout Australia. So that's a brief background.

DR CRAIK: Thanks. Thanks for your submission too. That was useful. When the county council was established, did anyone think about a corporation? Were other models considered, I suppose, and I guess - - -

MR HANINGTON (MW): It was a strange situation. Three of the county councils in New South Wales, Goldenfields, Riverina and MidCoast Water, came out of the electricity industry when they corporatised the industry way back in about 95, I think it was. There was two inquiries because the government had the idea of selling off electricity but they couldn't touch water. So I think there was two inquiries. The Office of Water was involved, the Department of Local Government and the two local councils, which were Great Lakes and Taree. They all agreed that a county council model would be the best model to serve the area.

Then there was another inquiry because I think, from memory, treasury said, "We should have a corporation," but they reconvened, but they still stuck with the county council model. They thought it was the best way to serve local government at that particular time. So basically, I suppose, after the two councils said, "We would like a county," it was then forced upon us and I think we were given six weeks' notice to start, so it was a pretty steep learning curve for us all.

DR CRAIK: Were council assets given to you guys or - - -

MR HANINGTON (MW): There's misapprehension about the assets. When you think about it, it's not the council assets, it's the customers. The customers supply the assets with help in the past from the government and then we borrow money or we

have fees and charges and rates to pay for those assets. All that was happening was the same people got their assets back. Another body looked after the custodianship, but basically it wasn't the council assets, it's the peoples, and the same customers became the same customers as the county that were in the two constituents. So, from that point of view, I can't see where councils think that there's a value in those assets. In our case, we received assets which were probably not in good condition, so we had to spend a lot of money to get them up to scratch.

DR CRAIK: Do you now give dividends to the councils?

MR HANINGTON (MW): No, we don't because at the moment, like most of the coastal councils where you go through these growth cycles, we've worked out really every 20 years is when you have your upgrades and especially with water in the Manning, the first upgrade was in 1967-72, where they built a dam; the second upgrade was in about 85-87 where they extended the supply to the small coastal areas. Now we're faced with the next upgrade where we have to upgrade the system for the next 20 years for growth and if we bring on new villages. So we have this lumpy expenditure, and most of the councils on the coast are the same, a lot of them have just gone through that process, so our balance sheets look pretty awful because we've got high borrowings. But, say, in 10 years' time, we'll be sitting back and saying, "Well, we've covered the growth, we've got the new customers coming and our infrastructure is sufficient."

DR CRAIK: We've had quite a discussion about full cost recovery with some of the other participants here and the Office of Water's metrics. Do you have a view about that at all?

MR HANINGTON (MW): The metrics of the percentage of - - -

DR CRAIK: The economic real rate of return and - - -

MR HANINGTON (MW): I don't really have a problem. You've got to be careful because in the country areas - and I think everyone acknowledges that we supply in our area, outside Taree, Forster and Tuncurry - we would not even break even. It's a cost negative in all those small towns. For instance, at Stroud - and we did five years ago our developer charges - basically it costs around 34,000 to provide water to a property in the village of Stroud, whereas in Taree, it's probably five to six thousand. So that's the scale that we have to operate under, where we've got to provide people with full service and they all expect similar services, and that's the problem we do face, that in the country areas, regional areas, it's very difficult to get high rates of return because of the small villages we've got to look after.

DR MUNDY: So the developer charges are different depending on where the - - -

MR HANINGTON (MW): No, there's a formula which you can have set developer charge across the whole area. The Office of Water audit those charges. Every five years we send our charges down and how we arrived at them and they audit the figures to make sure that they're comfortable with how we arrived at the figures. Two years ago, there was an IPART inquiry into headworks and MidCoast Water is one of the few councils that followed the rules and got a tick from the developers, even though it didn't agree with the rules, that we had followed process and got the right answers.

DR MUNDY: Sorry, I didn't quite get the answer. So you charged the same developer charge in Taree - - -

MR HANINGTON (MW): As we do - - -

DR MUNDY: - - - as in Stroud?

MR HANINGTON (MW): Yes.

DR CRAIK: Even though the cost is much more significant.

MR HANINGTON (MW): Yes. You've got to have some sort of cross-subsidisation or those villages would not grow at all and you have to provide minimum infrastructure. So often when you provide infrastructure, I think under the subsidy rules it was about 20 per cent growth factor allowed in that infrastructure, but it is just so costly even under that scenario to - - -

DR MUNDY: Have yourselves or anyone else in the water sector ever suggested to the state government that that's perhaps an economic development obligation and they should be funded by CSO, consistent with National Competition Policy principles and the - - -

MR HANINGTON (MW): The state government haven't got the money. They wouldn't have the money to do that under that scenario.

DR MUNDY: So they're not getting any improvements in the value of the land and improving their land tax receipts?

MR HANINGTON (MW): Again, in those small villages the land probably is less than in the towns but I don't think in their return, when they do sell the properties - the margins don't increase a great deal.

DR CRAIK: Thanks. In the attachment to your submission, you've said over the

last eight to nine years, your customers' water usage has declined while the number of connections has actually increased. You've had this user-pays system phased in. Can you talk to us about that and how prices have been used to - - -

MR HANINGTON (MW): The user-pays system has had a marked effect. Again in most cases with councils, our kilolitre charge is very high compared with the western areas, mainly because of the infrastructure we've had to put in. Also, the sleeper in all this - we talk about water restrictions - but the big sleeper in the whole thing is environmental flows. You don't have to have a drought to be restricted from taking water from a water source. That's the biggest challenge that we face. A really good example is the - - -

DR CRAIK: You're talking about the management plans that are - - -

MR HANINGTON (MW): Yes, the water-sharing management plans. A good example is the Coffs Harbour/Grafton water supply, they spent some \$180 million. Without environmental flows, they probably would not have had to spend that money. They did get about a 20 per cent subsidy under the town scheme, but I think the whole thing is no-one has put a price on the environmental water and at the moment the communities are expected to fully fund that environmental water price. A lot of the things we put in place are to protect the environmental flows, not to restrict water restrictions.

DR MUNDY: So you're saying there was a whole pile of expenses incurred by a utility to meet an environmental obligation which really they didn't need to incur?

MR HANINGTON (MW): No, it could have been reduced somewhat because in our case, we have a very strong robust river, our dam is only small, and the last time we had water restrictions was 2002. Under the river sharing plan - I'm not sure which month, either November or February - the acid rating the river, we may be restricted from taking the water in that particular time. The fall-back for us is we're developing a bore field which will cost \$30 million. We will double the size of the dam - the sole purpose virtually of the environmental flow regime under the water sharing plans. I think that is going to be the biggest challenge, regardless of where you are in New South Wales in the future. They're lucky in the western areas, they've got the Murray-Darling scheme where the government is prepared to put money in, but in coastal councils, we will not receive any money for what we have to do for environmental flows.

We're all in favour of environmental flows. We believe if you have a good river, you're going to attract recreation, tourists, and you're also going to end up with a good outcome for the environment but we believe that there should be a bit better cost-sharing arrangements.

DR CRAIK: Who do you reckon should pay for it?

MR HANINGTON (MW): I think it's probably a combination of state and federal. The state hasn't got any money, probably; the federal government is the one more likely to be able to do it. But the state has to do certain things under COAG and I would imagine the flows in our rivers are one of those.

DR MUNDY: So when these environmental flow requirements were being assessed, was there any public analysis undertaken of the costs that would be incurred and was there consultation, or was there simply a scientific assessment of the breeding needs of the fish?

MR HANINGTON (MW): No, I don't think there was anything undertaken on costs. I think it was a scientific assessment which was probably flawed because they set the same rates for all rivers. We've nearly finished a study which probably cost 600,000 over five years. We decided - and the Hastings council did the same - we needed to ascertain what is the environmental flow, not just a figure that's been plucked out of the air. I think they used European figures from memory. We've done a scientific study. We're getting close to the end of that, and we hope that that will give us an indication of what the actual environmental flow should be and when it should occur, not just in droughts or whatever. So we are hopeful that we do lessen the impact, but we're still not sure. Again, we thought it was good business to do those studies because I think today in our industry not enough scientific work is done before a decision is made.

DR CRAIK: In your submission you have referred to a rate - you say it only applies to general fund rate increases, it doesn't apply to water and sewerage charges. You've said where it does affect these areas is when councils, particularly the larger councils, use their water and sewerage businesses to heavily subsidise the general fund. How does that actually work?

MR HANINGTON (MW): It works in a few ways. I can quote things and I won't mention councils. Some councils may have their council depot and their council offices, and not all of them do it but some will - say there's three funds, water, sewer and general fund, so that's a third each. Two, water and sewer, might only take up 10 per cent of that area or have 10 per cent of the services. That way, the general fund is subsidised. There's other instances where they might extend their offices and then expect an equal share from the two funds and then turn around and lease the office space back to those funds. Some councils charge for the water pipes and the sewer pipes in the public footpaths which was outlawed under the Telstra case, but some of them said because it's internally, it doesn't matter. I had one water manager talk to me one day and said, "Look, the council is short of money in the budget this

year. They've asked for an extra \$100,000 in administration expenses." They have other instances where they may use the council's parks and gardens crews to do the lawnmowing and when they compare our costs, what we do - and because we're a bit different, we go and get our sheltered workshop to do it because it gives people with disabilities employment - you could have 70 per cent savings in costs. These are all the little things that add up. I suppose dividends are transparent but the way most of them do it is through the overheads. They add the overheads on.

DR CRAIK: Okay, thanks. Your submission again was interesting when you said you were formed in 1997 when the local councils were concerned about job losses and so for the first two years, you were going to try to fill positions from the councils. So I would be interested in your comments on that and what happened.

MR HANINGTON (MW): It was unique. First of all, we tried to get the local councils to do our administration for us, but because there's two of them - and I can see their problem - if one attended for three or four years, then lost it after that, they would have a problem with staffing. They also told us that if we wanted extra work, it was going to cost us a lot more than we were prepared to pay. So we decided that we would set up our own structure, but what we'll do is we'll take the risk and we'll advertise as internal advertisements to give the councils opportunities to staff that put in. The risk we took was that the not so good staff would put in and the good staff would stay, but it didn't work like that and the problem we had was that we would put someone on and then the council would go and advertise for that replacement position. We probably only took five or six staff, because we were running fairly lean.

So I think the scare-mongering that goes on about job losses, especially in coastal areas, is probably not valid. The other thing to remember too is that we took a conscious decision that all the work that could be done locally is done locally. So rather than build a garage and do our own servicing, we contracted it out to the community. The local garage, if it does a poor job, knows it's not going to get the work. We have the local welders. We can get them at 24 hours a day notice. They come out and weld our pipes if we've got breaks. We don't have to run all these auxiliary services which are run in general purpose councils and sometimes you wonder why you need to run those services. What you do is you create jobs locally, but the council itself doesn't put employees on, you create the jobs in the community.

DR MUNDY: One of the issues that we've been a bit concerned with is the lack of uniformity and occasional absence of arrangements for consumer protection and complaints. What is the situation with your - - -

MR HANINGTON (MW): We consult very heavily with our customers. Some of these are five or six years old now. All our expansion plans for water with bore

fields and our treatment plants, it all comes from the community. I think in that particular case we had six options. They came back with their preferred options and we're slowly working through those. Integrated water cycle management, we did it all ourselves, but we had community focus groups and they came back, we gave them the options of what we could: build more concrete structures or look at catchment management. They came back with, "We need to do the bore field and the dam raising, but we also think catchment management is very important and we're quite happy for MidCoast water to put money into catchment initiatives so we can improve the water quality in our rivers." Our customer satisfaction was in the high 90s. One of the things our customers tell us is they like dealing with us directly and our staff on the other side say it's really good because they're recognised as being MidCoast Water staff, not ex-council staff. They feel that often the water staff wrongfully are lined up with the general fund, where you have most political problems.

DR MUNDY: I asked a question of the previous participants about the pros and cons between the council model and the alliance model. Your submission casts some light on that. Do you want to give us some reflections? It seems to us, I guess, that in some places the alliance models are really working and achieving outcomes for people and similarly in your case. I'm interested to try and see if there's a golden nugget in here somewhere about where this works and what might form the basis for saying, "It might be better here than there."

MR HANINGTON (MW): I don't think in the long term the alliance model can survive. Local government is very fickle and I think the alliances that have formed are doing an excellent job. They've bitten the bullet, but there's only two really that have gone ahead and did something. The rest of the local government sat on the fence and they're waiting to see what happens. Some of them think, "The alliance is good and in about three or four years' time, we'll get out of this and we're back to where we were." The alliance has done a lot of good work, there's no doubt about that, getting the technical skills in the small councils.

I think at the end of the day, when it comes down to the dollars to replace the infrastructure, that will be the test. I've got a theory that the big regional cities or regional towns that get most of the funding, they will at the end of the day - and that is how our model was built for the state, it was built around the regional cities - that they will have to put something back into those regional areas. On the coast we're footing the bill ourselves. Perhaps inland the regional cities might have to look at increasing their charges to coastal charges and look after those small towns who, in the future, will just suffer if they haven't got the skills now. I can't see them importing the skills. I think at the end of the day, the alliance will serve a purpose, but they may have to look at something else a bit further down the track.

DR MUNDY: So once the capital issue starts to bite, you think that's where the - - -

MR HANINGTON (MW): I think that's right. A good example is what we've quoted there, Gloucester. Gloucester Council, they sit at the top of the Manning River, they've got 1600 customers. I think their water and sewer is at 1.9 million in each fund and their infrastructure is failing. Their waste water plant is not meeting licence conditions, they've got only three staff members, who are paid very poorly, they haven't got the skills. They put their hand up and said, "Look, we've had a look. We've suppressed our rates for a number of years and we've put them up in the last couple of years around about 20 per cent each year." They're put their hand up and said, "Look, we need help and we're quite happy to have an arrangement." So part of the arrangement is we give them equal say. Even though they're small, we believe that they should have equal say alongside Taree and the Great Lakes, because we don't believe that one council should dominate in a county structure.

DR CRAIK: So your county council, is that made up of a number of representatives from each of the councils?

MR HANINGTON (MW): Yes. It's made up of three from Great Lakes, three from Taree and it will now be three from Gloucester. They'll review that prior to the next local government elections and I think the general feeling is that they'll go back to two delegates from each of the councils.

DR CRAIK: Have you got an independent chair or - - -

MR HANINGTON (MW): No, we try and - because there's always jockeying for chairmen. The councils realise that they're there to serve their constituents, so they take it in turns of being the chair, but the three delegates from the Great Lakes may elect one of their people to be the chairperson and then Taree will elect the deputy chairperson and then next year the roles reverse and that way we find it is a very even way of doing business and we don't have parochialism, which is quite good that they come onto the county. They often get criticised because they will not listen to their own council's wishes for how MidCoast should be run. They stand independent when they're on MidCoast Water. It's on the public record. One councillor got up with his council and said, "When I'm at MidCoast Water, I'm MidCoast Water, so don't try and influence my decisions."

DR MUNDY: Either the legal framework around the council or its articles, does that make it clear?

MR HANINGTON (MW): Yes. In the Local Government Act, there is a section which deals with county councils and how they should operate.

DR MUNDY: Are there offences that are associated with this or is it - - -

MR HANINGTON (MW): Yes, they're the same offences that apply to an ordinary general fund council.

DR MUNDY: No, I'm talking about this conflict issue.

MR HANINGTON (MW): No, there's not, no.

DR MUNDY: So, "We hope that the people who get appointed to counties act appropriately and we tell them by statute they do and if they don't, there's no particular sanction."

MR HANINGTON (MW): Only if they're sanctioned by the Department of Local Government.

DR CRAIK: One question on consumer protection and hardship. Would some kind of best practice principles for small to medium water utilities be useful or is it - - -

MR HANINGTON (MW): For consumer hardship?

DR CRAIK: Yes, and protection.

MR HANINGTON (MW): It's quite interesting. We have a lot of repayment plans in place.

DR CRAIK: Of your own that you've developed or is there some kind of standard plan?

MR HANINGTON (MW): No, it's not a standard, but really when you think about it, it's pretty much commonsense. The lower people in the community, they struggle, so we have plans in place. We know we're pretty high charging because of the infrastructure. We also took the situation where we don't charge interest on outstanding accounts, because in most cases, there's no use putting interest on people that are struggling to pay, because they can't pay the account anyhow, so why add another 9 per cent to it? So we're prepared, as an organisation, to carry that. So I think that's probably our way of trying to deal with the hardship laws. We do other things. With the local councils, we do give them a bit of a discount on the fixed charges on, say, their swimming pools, not the usage charges but we'll give a 50 per cent fixed charge rebate which we show as a community service obligation. Public toilets might be on a system charge rather than a straight-out fixed charge but we show that a community service obligation in our accounts every year. So

anything we do, if we ever do a discount, it's always shown in our accounts as a community service.

The only issue we do have is that pension rebates, like most of the councils, we don't get our fair share.

DR CRAIK: What do you mean you don't get your fair share?

MR HANINGTON (MW): The state government sets the rebate which, to be fair to our pensioners, is pretty low. It's been, since 1982, the same. But all councils, regardless of water and sewer, we have to foot 45 per cent of that bill and that is a big impost upon coastal areas where you might have 26 per cent of your customers as pensioners. I think there's about 700,000. We could do a lot with that 700,000 with our infrastructure is the government picked up the tab.

DR CRAIK: The government only funds part of the pensioner rebate. Is that what you're saying?

MR HANINGTON (MW): Yes, the New South Wales government funds 50 per cent, the Commonwealth 5, and we fund the other 45. So you can just imagine if your council is struggling for funds to maintain their roads and that, that's a big impost on those councils.

DR CRAIK: So do the councils pay the difference or does the county council actually - - -

MR HANINGTON (MW): No, we pay for our own pensioners, the water and sewer rebates; the councils have to pay - I think they get \$250 - the pensioner's rebate on general rates. The council has got to foot that bill which is pretty unfair. That's why the pressure comes on to get more out of your water and sewer businesses.

DR CRAIK: Yes, okay.

MR HANINGTON (MW): There was one question about stormwater.

DR CRAIK: Yes.

MR HANINGTON (MW): Stormwater is not a big deal in the whole water cycle management process because it's very expensive to treat it. I think of recycling of waste and so on; stormwater is very expensive to recycle. In our case, most of the stormwater is coming from roads which goes into drains which goes into the river, so I think stormwater, for us, it would not be a business that - well, you wouldn't make any money out of it. All you're doing is picking up the problems that already exist.

DR CRAIK: So you don't want stormwater - - -

MR HANINGTON (MW): If there's no benefit to your customers and you can't make use of the resource, it's pointless to have that.

DR MUNDY: If you captured it and reused it, how would that affect - - -

MR HANINGTON (MW): It would go straight in the river anyway, so it's going in there anyhow, but it's always in your estuaries. One of the big issues with stormwater is you can treat it but you've got to store it somewhere, and the actual storage - you'd have to build a dam probably the size of what we've already got to store the water - - -

DR CRAIK: I presume you'd have to pump it too.

MR HANINGTON (MW): That's right. Where you collect is always a long way from where you store it, so that's the other problem you face.

DR CRAIK: Okay. Thanks very much, Neil.

DR MUNDY: Thanks for that.

DR CRAIK: That was great, thank you.

DR CRAIK: Our next person appearing is Infrastructure Australia. If you could state your name and your position for the record and if you would like to make a brief opening statement, we would be pleased to hear it. Thank you.

MR BRENNAN (IA): Thanks, Wendy. Rory Brennan, executive director infrastructure investment at Infrastructure Australia. I would like to make some comments in addition to our submission. I won't reiterate the content of our submission but perhaps some additional comments.

I think in summary there's three important points that need to be made and that is that at least four independent reviews are indicating the need for reform in the urban water sector and they are coming up with very similar directions for that reform. I think there is evident resistance to reform, not only to previously agreed reform, such as in the National Water Initiative, but to the reforms that are being proposed now. The impact of that resistance shouldn't be underestimated. The third point is that I think policy purity is probably less important than progress with reform. The second-best option, if it's implemented, would be far more effective than the first best that isn't implemented.

Now some comments on some specific issues: as far as price regulation is concerned - this is quite a topical issue that the commission has set running - I think the experience in the water sector is that independent price regulation is effective in applying discipline to cost efficiencies that wasn't as evident prior to regulation. I think IPART's comments here in relation to the staffing levels in Sydney Water pre and post regulation are relevant.

In terms of the aggregation of small water utilities in New South Wales and Queensland, we've been satisfied to see in submissions to ourselves and the commission that a number of local government bodies, particularly in New South Wales, have recognised that local government-owned regional water corporations are a preferable model. However, as I said before, there remain serious obstacles to this model being widely implemented. The most notable of these is the position of the New South Wales Local Government and Shires Association, that there are no problems, nor a need for change. While this position has been largely debunked by the commission, the National Water Commission and the Gellatly review, the Local Government and Shires Association continues to promote this line in regional communities.

The Local Government and Shires Association's preference for regional alliances is, in a practical sense, the no-change model. This is particularly relevant in terms of the commission's and other reviews' identification of governance as a key issue in terms of performance of water utilities. In the face of this sort of opposition

- and this is coming from a very practical sense - the county council model provides a middle ground that should bring most of the benefits of regional corporations.

In terms of the Australian drinking water guidelines, I think a note of caution has to be sounded over the reliance on risk based management systems to assure water quality. It's not that they're not effective, it's that without rigorous compliance of performance monitoring, they run the risk of being a paper based and process focused approach. There is evidence of regulator-required management systems being applied to meet strict compliance requirements and regularly failing to manage the risks they are meant to; things like environmental management systems and safety management systems stand out here.

If you're going to rely on management systems, there needs to be independent and rigorous testing of these systems. This means typically that regulators need to apply resources that they currently don't have and the submissions that we have had from state health departments have pushed this line quite strongly, that if you want to rely on these things, then it will mean extra resources; not an unusual comment from a state government agency. They're the points I would like to make and I'm happy to take questions.

DR CRAIK: Thank you. You say that the county council model sounds like a reasonable move towards the corporation that your report proposes. Do you think there might be some case for retaining local council utilities in some areas of New South Wales and Queensland?

MR BRENNAN (IA): Yes, the report that we have commissioned proposes for New South Wales and Queensland aggregation and proposes the regional water corporations as the preferred model. It doesn't propose a set of boundaries, a set of preconditions for that. I think the suggestions in the commission's draft report about looking at a particular purpose approach, that is definitely the way to go. There are going to be some towns in some local government areas which are quite sustainable as the arrangements exist now in terms of the coverage of their water authority. I think there's still real argument, strong argument, for separating the water utilities away from council.

DR MUNDY: So on that basis, you wouldn't support the recent decisions taken in south-east Queensland to move water utilities back to local councils?

MR BRENNAN (IA): No.

DR MUNDY: With all due respect, I think your summation of the evidence that's provided to this commission and indeed the views expressed by this commission that we had a preference for regional water corporations is perhaps drawing a long bow.

We were careful to express no preference and we indicated that perhaps a suite of models were appropriate. We know that regional water corporations seem to do a reasonable job in Victoria and we know that county councils and alliances do seem to be doing a good job in New South Wales. I accept IA might have a view but we have others.

MR BRENNAN (IA): I'm sorry, the intention there was to indicate the preference for aggregation rather than the specific model.

DR MUNDY: Just a couple of other points you made: where is the resistance to reform coming from and what is it?

MR BRENNAN (IA): From our experience to date, it's coming particularly from elected officials in local government.

DR MUNDY: So it's not coming from state water ministers under cost of living pressures?

MR BRENNAN (IA): No.

DR CRAIK: It was raised - - -

MR BRENNAN (IA): In New South Wales and Queensland, which is where the aggregation is recommended, that hasn't been evident to us.

DR MUNDY: No, I'm talking about water reform more broadly.

MR BRENNAN (IA): Sorry.

DR CRAIK: What's the evidence of it? How has that manifested - - -

MR BRENNAN (IA): In terms of broader reform, I think the evidence is the lack of progress against the National Water Initiative; it's very patchy. You've got the instances where significant reform is rolled out in Tasmania and then the government comes in over the top and puts a limit to the extent to which that's actually carried on. Then you've got recent examples in Queensland where the government comes in and puts a cap on water prices. There's widespread - well, uniform agreement to progress the National Water Initiative and the principles, but when it comes down to getting action to happen on the ground, then that's when you get problems and typically - - -

DR MUNDY: But they're actions of state governments - - -

MR BRENNAN (IA): Indeed.

DR MUNDY: - - - not local elected officials. Would IA be similarly concerned about the recent direction given to IPART by the New South Wales minister about how the independent pricing regulator should basically do its job?

MR BRENNAN (IA): I suppose we haven't looked into that, the recent direction, very closely at all. I think IPART has indicated that it's got some concerns around that. Certainly my experience goes back to the New South Wales government giving directions to IPART, particularly in relation to the desalination plant. You would have to really be concerned about the scope for that sort of activity to be broadened.

DR MUNDY: IPART itself has expressed concerns about the legal framework that enables it to be given these sorts of directions. It's done so, not just in this inquiry but in other places it's raised this concern. It's a legitimate concern. Given IA's broader brief, is this a matter that your organisation from a national infrastructure policy perspective is going to give some consideration to?

MR BRENNAN (IA): I think our view at the moment is that the complements of reviews which has concluded in the Productivity Commission's inquiry is a great vehicle for looking at the situation and coming up with a proposal for reform. We are more than happy to participate in that process. Rather than saying, "Okay, now let's strike out on a separate and parallel stream," let's look at where this gets to, particularly what the appetite for implementation is and then say, "Okay, is there something else that's there that we need to look at?" There are a number of major initiatives where we have sought to not duplicate process; the national broadband network and the Murray-Darling Basin are two of those where we've said there's a massive process happening there, we don't want to come in over the top and prejudge the outcomes there or prejudge the effectiveness of a policy that's being proposed there.

DR CRAIK: Can I move on to rates of return and full cost recovery. I'm just curious about the AECOM report. Beyond using the data from the National Water Commission and Office of Water, do they use any other data? Did they independently investigate any other data?

MR BRENNAN (IA): No, they relied on the publicly available data.

DR CRAIK: Okay. Do you consider that the Office of Water's approach to measuring full cost recovery is appropriate?

MR BRENNAN (IA): We didn't take a strong view in terms of their methodology. There have to be real questions asked about the extent to which utilities that are claimed to be recovering full costs is actually true, both in the sense of: are they

actually getting a real rate of return? The other thing is the base on which those calculations are made, I think there is quite obviously, particularly in regional areas, very run-down infrastructure. If you're looking at recovering the costs of operating that infrastructure - I'm not confident at all that local governments are recovering the costs to replace that infrastructure.

DR CRAIK: Does IA have a view about an appropriate or a sufficient real rate of return for a water or sewerage business, a full cost recovery - - -

MR BRENNAN (IA): No.

DR MUNDY: But presumably it's not zero.

MR BRENNAN (IA): That's right.

DR CRAIK: Do you think where currently they do earn low or negative real rates of return, it's a function of the scale and the structure of water utilities - in other words, do you think it's likely to change if structural reform occurs as - - -

MR BRENNAN (IA): I think the evidence the commission has pointed to in the draft report about the economies of scale that are available, there are real signals there in terms of the potential for regional water utilities to operate much more efficiently. The other side of the coin is pricing. At the moment, there's significant influence brought to bear on pricing which means that even if you do run efficiently, you may not be able to recover the costs.

DR CRAIK: In Victoria of course, where they have amalgamated some of the regional utilities, some of them still earn negative economic real rates of return, even though they're also regulated, price regulated.

MR BRENNAN (IA): Yes. We certainly don't want to underplay the difficulty that regional areas face in funding infrastructure because as Neil has pointed out, it is very difficult to fully recover the costs of infrastructure when you're dealing with dispersed populations and expensive infrastructure. In Sydney Water, for example, servicing existing fringe developments with sewerage was running at around \$55,000 a property. That was just smeared across the sewerage cost of all Sydney customers. It is significantly costly and inevitably a political decision is going to be needed, "Okay, how do we deal with those costs?" and typically, the politically easiest solution is the preferred one.

DR MUNDY: "Smearing" has a pejorative taint to it. Does IA have a view that that is an inappropriate way to recover the costs? Would you favour a more location-specific recovery or - - -

MR BRENNAN (IA): Yes.

DR CRAIK: So developer charges that reflect the real cost.

MR BRENNAN (IA): Indeed. It's interesting, in Tasmania, quite separately, Infrastructure Australia has a submission before it about funding the Tasmanian water and sewerage program which is about a billion dollars. It's interesting there that \$800 million of that program is being funded by customers in Tasmania, but there's \$200 million which is deemed to be uneconomic and which is where they sought assistance from the Commonwealth Government. But it ran to providing reticulated sewerage to extremely small towns and at some point there has to be a decision taken as to, "Is this really the way to go? Is this really over-servicing? Should it be reasonable for every person in Australia to expect to have reticulated sewerage, no matter where they live?"

DR CRAIK: Does IA have a view?

MR BRENNAN (IA): Our view would be that you need to make that decision. There needs to be a line drawn that it isn't a universal right of access.

DR MUNDY: Would IA be prepared to recommend to government funding in the event that the state of Tasmania wasn't compliant with the NWI pricing principles, particularly full cost recover, given the utterances of the premier of Tasmania, shortly after her elevation to office, where she said words along the lines of, "Full cost recovery is not the policy of the Tasmanian government."

MR BRENNAN (IA): It's an issue that is separate to this report in terms of our advice to the government on the proposal for funding and we've already had discussions with the Tasmanian government in terms of that.

DR MUNDY: Surely IA would expect compliance with national agreements before it recommended funding.

MR BRENNAN (IA): Indeed.

DR MUNDY: So that will be part of your consideration.

MR BRENNAN (IA): Yes.

DR CRAIK: Have you ever funded any urban water projects as IA under the Building Australia Fund?

MR BRENNAN (IA): No. We've got coverage of the water, energy, communications and transport sector and all the projects that have been recommended to date have been in the transport sector.

DR MUNDY: So this is the first water one?

MR BRENNAN (IA): We've had lots of submissions to fund water and particularly energy in the water sector, because we've had submissions to fund energy projects, because our view is that where there is an effective market or quasi-market situation in place, that users should be funding this infrastructure, unless there is an argument that there has been subsequent market failure where the government should step in.

DR MUNDY: So you didn't fund Pilbara Cities at the end of the day?

MR BRENNAN (IA): No.

DR CRAIK: Your comment in your submission about incentives for reform, what sort of incentives do you think there need to be and who should pay? How do you decide?

MR BRENNAN (IA): It's a difficult area and I think it again comes down to our preference for action, rather than perhaps theoretical purity, is that if we think that there is benefit to be gained from reform - and if we don't think it, then we wouldn't be going there. But there are real difficulties and there are precedents for support being given for progressing reform to recognise the pain that it does impose on the people who are being reformed. Then it is something which governments should take into account in determining how they want to get action.

DR MUNDY: So in those circumstances, if the Commonwealth was to provide some assistance to aggregation of utilities in South East Queensland and New South Wales, your view would be that that funding should go to the local authorities experiencing the pain or to the states?

MR BRENNAN (IA): We haven't got a structure in mind, but I think the intent would be to look at where the pain is being felt, particularly in terms of the costs and to focus those incentives on the bodies that are actually going to implement the reform, so I think in those cases, it would more than likely be the local government dealing with local water utilities.

DR MUNDY: So, for example, if there were legal costs in establishing new entities that were going to attend to this aggregation, you would see that would be a reasonable thing that the Commonwealth could just stump up and say, "We'll pay X bucks per - - -"

MR BRENNAN (IA): That's the potential option.

DR MUNDY: That sort of thing, rather than an NCP-type arrangement, where you would say to the states, "If you achieve these reforms, here's 150 mil."

MR BRENNAN (IA): I wouldn't like to see the situation where the government funded legal costs which were to no effect.

DR MUNDY: No, but I'm talking about the normal costs of drawing up articles of association and those sorts of things.

DR CRAIK: There's just one question that you will have heard this morning and you will have seen in the submissions that we've received, and you've received many yourself, I would imagine: that local governments, particularly in New South Wales, have been concerned about the data and findings of the AECOM board. Do you have any response to that?

MR BRENNAN (IA): We have had, at last count, about 30-odd submissions on the AECOM report. By far the majority of those have been from local government association and local government officials in New South Wales. It is interesting that while there is comment that the report is riddled with errors, the majority of the comments contest the findings and conclusions, rather than the data. We have had a range of corrections proposed to the town data sheets that are in volume 2 of the report, but by far the majority of concerns that have been raised with the reports are about the logic that leads to the findings and the conclusions and the recommendations.

DR MUNDY: Given that - and I think the analysis you've just provided is not an unreasonable one - will you be publishing a revised, corrected version of AECOM's - - -

MR BRENNAN (IA): No, we won't. Our approach to this process and the way that we've responded to a number of people that have come back to us, as well as acknowledging the reports, where they've come back, for example, to our minister or to our chairman or to ourselves, is that our view is that the AECOM report is out there, it's an input into the debate that is happening and particularly that's feeding into the Productivity Commission's inquiry, and we see this vehicle as the most appropriate forum for people to bring their concerns and talk about it. We don't want to run a parallel initiative to come up with further reform proposals.

DR MUNDY: It certainly would be our normal practice, if confronted with the fact that evidence was incorrect, that we would seek to ensure that a document which will

persist on the public record is at least corrected.

MR BRENNAN (IA): We intend to publish the submissions that we've got that outline where people consider there are inaccuracies.

DR MUNDY: But there will be no corrected - - -

MR BRENNAN (IA): No.

DR MUNDY: So to understand that the document is faulty, I will have to go through a raft of submissions.

MR BRENNAN (IA): If we thought it was fundamentally compromised, then we certainly would withdraw it. We don't think that's the case.

DR MUNDY: So there won't be a small erratum or anything like that?

MR BRENNAN (IA): No.

DR CRAIK: Thanks, Rory. Thanks very much for appearing and thanks for the submission. Now we'll break for lunch and we'll resume at 1.15 with H2O Organiser. Thank you.

(Luncheon adjournment)

MS CRAIK: Thanks very much for your submission and thanks very much for coming along today, and if you could open by stating your name and your position and organisation, and then if you'd like to make a few brief opening remarks we'd be happy to hear from you.

MR PORTER-COOTE: My name is Robert Porter-Coote. I'm the managing director of H2O Organiser Ltd. With me is Mirek Sulkowski, who is the design engineer with the company as well. We have had reticulated water with us since Roman times and no-one yet has figured out how to turn the tap off if it's left running. Our technology addresses this, and it's our submission that in the waste of urban water or the conservation of urban water we must be able to address one of the root causes of the thousands of litres which are wasted by running taps and other causes for water to run. That's our submission, and I'm happy to answer any questions.

MS CRAIK: Thank you for your submission. It's fascinating, I'd have to say. So perhaps you could give us an idea of if it's financially attractive to install them, why do you think it would be necessary to provide a rebate to ensure that people actually did it. I guess my other question related to that would be, given while everybody was trying to save water actively during the last few years - like, Sydney Water was making big efforts - did you try to persuade them to take up your technology, and we'd be interested in your story about that.

MR PORTER-COOTE: In the general uptake of the technology and when we have spoken to people they sort of look and say, "Yes. Do I really need it?" If you were to interview 10 people - and I've done this numerous times - who had some sort of reticulated water system, three out of those 10 people will recite a problem that they had, it could be a leaking hot water system that busts - they have a life expectancy of about eight to 10 years and they bust - to the dishwasher pipe busting, and they wake up in the morning and they say, I've now got two inches of water throughout the whole house.

People tend to put their dishwashers on at night-time, and in Sydney that's when the water pressure is the highest. With new houses and new developments, if you have any plumbing work done, you have got to put a regulator on to stop the pressure. With older houses the pressure can go three times the normal water pressure, and any problem with the pipes and that's when it happens and water just fills the house and does huge damage. The Insurance Council tells us that the average claim for household egress of water is five and a half thousand dollars.

MS CRAIK: That's nationally?

MR PORTER-COOTE: Yes. Because of that, then people say, "Well, I really can't do anything." When we started on this journey which has taken us - well, me, personally, 17 years, when we first developed our first product, which has to do with pressure pumps, a similar thing, I was told by the manufacturers and the retailers, "Hard luck, mate. Learn to live with it. There's nothing that can be done to stop an overrun or a leaking pipe. It's just one of those things that happen." I didn't take that and I pursued the matter.

In our submission we have got some details about the amount of water and the huge waste of water that occurs in Sydney schools. I don't spend all of my time walking around schools to see where they're wasting water, but, for instance, Singleton High School has 1300 students and it has about 300 toilets in that school, and I'm quite sure the principal or the caretaker doesn't stick his head into every toilet cistern to see if it's leaking, they lock it up.

Councils tell me that regularly their ablution blocks on parks and gardens suffer from either vandalism or the fact that someone has left a tap running - maybe because they lost the match and they're out there and they're ready to go home - and the ablution block gets locked up. Our device is the only active item that stops water. Sure, you've got Smart water meters which will tell you after the event that you lost water, but our device is the only active one that says, "You're losing water, I stopped the water."

MS CRAIK: Why haven't people like schools and Sydney Water and people like that taken it up?

MR PORTER-COOTE (H20): We've taken it to a number of schools and they say, "I'm the principal. I don't pay for the water," because it's not a direct cost to them. We've made some inquiries in Canberra where a school had to actually pay for the water and it comes directly off their budget. They've shown some interest, not a huge amount of interest, but generally water is water. Some have the tap. I've been in buildings - a good friend of mine is a solicitor in town - I said, "Do you know your toilet is leaking?" This was on a Saturday. He said, "It's not my problem, it's the landlord's problem."

DR CRAIK: Why hasn't the Real Estate Institute or someone like that - have you approached them, or whatever they are, the Property Council, people like that? Aren't they interested in taking this up?

MR PORTER-COOTE (H20): Not really, no.

DR CRAIK: But Sydney Water certainly, as I understand it, were very interested in reducing leakage from their system during the drought.

MR PORTER-COOTE (H20): Yes, that's from their system, but as I've spoken to them and also spoken to people from America, they feel their responsibility is at the end when it passes the meter.

DR CRAIK: But they were encouraging people to put on - and they ran these - "Dial-a-plumber," "Have a low-flow shower head," "Get a plumbing inspection of your place," do this and do that - to make your own household water usage more efficient.

MR SULKOWSKI (H20): But that's a little bit of a different idea, a different principle. It means the water authorities are not quite interested in saving water on the end user side because they are charging people per litre. They don't care how much water the user is using.

DR CRAIK: I'm just really surprised, given their focus on discouraging people from using water during the drought, that nobody was interested in taking it over?

MR SULKOWSKI (H20): We're surprised as well.

MR PORTER-COOTE (H20): Because, as I said, we've had reticulated water for a long time and no-one has come up with any technology to be able to effectively turn the water off if there's a flow. They sort of say, "Check your toilet," or, "Do this and have a look at these things." Many people who have swimming pools recount to us, "I was swimming last night, needed to fill the pool and then all of a sudden got distracted and left the water in and now the swimming pool is overflowing. Yes, I will get an excess water bill." It's basically a bit like a smoke detector for the water system.

DR CRAIK: Have builders been interested in taking it up then? Has anyone showed any interest?

MR PORTER-COOTE (H20): To be frank, I've had more interest from overseas than I have had in Australia, where places recognise - and one of the reasons that is that the places overseas, if you've got water leaking in your house, the big problem is that you will have mould closely following the water egress. So, yes, we have more interest from people overseas because in Australia, if water leaks into a normal house, you open the front door and the back door and hope the breeze flows through and dries it all out, whereas you can't do that in some areas in Europe and in the States where it's minus so many degrees.

DR CRAIK: And it freezes.

DR MUNDY: Or you've got hot-water based room heating and you don't know about it until it's too late.

MR PORTER-COOTE (H20): That's correct.

DR MUNDY: You mentioned BASIX in your submission. I can sort of understand why people are ex ante unwise, but I would have thought that this was something, given the raft of things that we've put into building standards for water conservation and energy conservation purposes, that that might have been a place that you might have got some - - -

MR SULKOWSKI (H20): We have a little bit of a problem with that because smoke detectors are compulsory now in every house and every unit, but you have X number of manufacturers where the customer can actually select, "I want this or that." We are the only ones in the world to actually develop this and patent it worldwide and there is nobody else. There's no competition as yet.

DR CRAIK: So why is that a problem, sorry?

MR PORTER-COOTE (H20): Because BASIX work this way: to get BASIX approval, you've got to be able to show how much water you will save. If you've got a low-flow shower head, you can measure how much water you can save by installing that. So there's an instant, "I install this, I'll save water." However, our device is more for the cataclysmic event. Because I can't quantify when you will have that event, it doesn't fit with the model that they've got that, "If I put this, this and this into the house, I will achieve either this feeding efficiency or this electricity efficiency or this water efficiency." Because it doesn't fit into one of those moulds, the BASIX - you can't get a tick with it. So the people who push the BASIX system says - it doesn't give me a tick.

DR CRAIK: What about the Green Building Council then? I would have thought - - -

MR PORTER-COOTE (H20): It doesn't give me a tick because I can't quantify how much water it will save.

DR CRAIK: Even for the Green Building Council?

MR PORTER-COOTE (H20): Yes. They're after measurable items.

DR MUNDY: But when they certify a four-bedroom house - and I own a four-bedroom house, my partner and I live in it - they don't know that I'm going to move in and each of us are going to use the spare bedrooms as studies or whether

we're going to put two teenage children in each one of them. So they're working on an expected water use basis because they don't know when they certify the house who is going to live in it and how much water they are going to use. So they must be working on an expected water saving.

MR PORTER-COOTE (H20): Yes.

DR MUNDY: So I would have thought that it would not have been that much more difficult to turn around and say, "We know that once every eight years the hot-water system is going to go, we know that once every so often a pipe is going to burst, and we can, on an expected basis, come up with a water saving by terminating those events." So it doesn't strike me, as someone who is a statistician, that that's a particularly complicated problem for a building standards agency to deal with, unless they choose not to.

MR PORTER-COOTE (H20): I agree with you but, as Mirek said, this is the only technology that's addressed this problem; there's numerous toilet manufacturers who get small-flush toilets and those things, that's something that you can readily go and find, whereas this is new technology and it's something that no-one turns around and says exists.

DR CRAIK: What about local councils, have you tried them?

MR SULKOWSKI (H20): It needs a lot of approvals but you can start to talk to them.

DR CRAIK: It needs what, sorry?

MR PORTER-COOTE (H20): There's WaterMark approvals which we are in the process of getting. The actual brain, the little box, doesn't need any approval and we've tested that that works. But it's the item - no, "Water is easy, I just turn the tap on." In my opinion we don't value water enough.

DR CRAIK: So is this thing commercially available? Can you go and buy it somewhere?

MR SULKOWSKI (H20): It's going to be, within the next month.

DR CRAIK: Has anyone got one of these at the moment? We have manufactured a hundred prototypes of field testing.

MR PORTER-COOTE (H20): The actual box, which is the brain, has been tested in Australia for over three years and the electronics and the controlling thing works,

works quite well. We haven't had a problem with it. The other parts of the device are freely available and they're just a solenoid which has been available for zonks and a flow measurer. You can go and buy those now, but no-one has coupled together the three things to make an effective stopping of the water.

DR CRAIK: So you can't go in just now and buy one off the shelf in a shop? You've got to put it together yourself or something. Is that - - -

MR PORTER-COOTE (H20): You will be able to buy one off the shelf in about eight weeks' time.

DR CRAIK: Okay. Do you think people will start - you should go on The New Inventors.

MR SULKOWSKI (H20): We tried.

MR PORTER-COOTE (H20): I went to The New Inventors and the girl that rang up from the New Inventors turned around and said - I said, "We'll need to talk to you about this." I said, "What do you know about pressure pumps?" She said, "I'm a work experience student and I live at Turramurra. I know nothing about that." I tried to explain it to her and she took notes and - - -

DR CRAIK: You should have asked her if she understood when a toilet leaked and then she might have understood.

MR SULKOWSKI (H20): Just in your house there is a good sample of how the device works because they have a tendency to have long showers and after you set the time for 15 minutes, after 15 minutes the water flow would stop. They have to go physically outside and press the button. So this will not encourage them to take the showers. That would save the water.

DR CRAIK: Yes.

MR PORTER-COOTE (H20): The example that I gave there was not only would it save water, it also has an enormous amount of saving for greenhouse gases because you have to pump less water.

DR CRAIK: So when you get these prototypes all up and ready, off the shelf and things, are you going to market it actively here in Australia or - - -

MR PORTER-COOTE (H20): Of course we're going to actively market it here in Australia and the price for someone to purchase one and have it fitted on their house as a retrofit is somewhere in the vicinity of \$500 to \$600. You asked the question

does a subsidy need to be put. At that price, do you really need the subsidy, is the question, and would the subsidy make people have it and is it more effective than putting a water tank in, for example. In the draft report that I read, water tanks were sort of - you said that that's one of the least efficient ways of saving water in a domestic situation.

If you have some sort of rebate, even a small rebate, it may encourage people to have it. If it was done so that it fitted in the model of the BASIX - and someone would have to rewrite the BASIX system, because that's one of those things that basically someone has already got the figures about how much water an average household uses and they use the average, if someone uses 800 litres a day, or whatever it happens to be for four people, because you can do that calculation quite easily if you put a water tank in. You know rainfall, catchment area, number of people who live in the house, how much water you need to do.

DR CRAIK: You must have figures on average leakage, like Warren said, so you could say, "Well, this will on average save you X leaks a year, or whatever it is."

MR PORTER-COOTE (H20): Because it's sort of a cataclysmic-type event - and when you go into the commercial area, there are commercial kitchens that their dishwashers leak and other things and buildings that just flow down from the top when the water goes. I've got an architect who is building a building in Sydney, who is going to be the first one in Australia to actually specify the Town Water Saver as part of the building, because he sees and he's an environmental architect basically and he sees that that doesn't give him a BASIX tick, but he's not really worried about that. He's really saying this will give the building the benefit of not leaking and causing damage from the top floor to the bottom floor if the top floor leaks.

DR CRAIK: That's impressive. So I guess the question is do you have lots of thoughts about how you're going to promote it once you get it all going or are you going to go overseas or what.

MR PORTER-COOTE (H20): Look, we're going to do both, because people in the States are interested in the product because they see that it solves a couple of their problems, stopping water and also stopping leakage. It will be marketed through the major plumbing outlets with a lot of exercise and a lot of effort to do that. Of course the fact that it's the only technology around of that, the take-up will be a bit difficult because, as I said, its sister product works on pressure pumps. Someone says, "Why would I want to do that?" Because six out of 10 pressure pumps sold in Australia are sold as a result of them going too long and burning out. We've gone to the major pump manufacturers and they have said, "Lovely product, understand what it does, but then we'd lose all of our sales."

DR CRAIK: Yes, because they wouldn't burn out.

MR PORTER-COOTE (H20): They wouldn't burn out or they would burn out less.

DR CRAIK: Yes. We have a pressure pump that keeps coming on - - -

MR SULKOWSKI (H20): That's what the problem is. Every time you leave the house, your water tank is going too long - bursts the pipe or starts leaking or - - -

DR CRAIK: I don't think about it.

MR PORTER-COOTE (H20): The figures that I have used in the submission for what would be saved in Sydney schools is a huge saving.

DR CRAIK: Yes, it's enormous, that's right.

MR PORTER-COOTE (H20): After three years, we estimate that it will pay for itself.

DR CRAIK: Do you think you will try to interest the water utilities in this or will you focus on the plumbers and the building - - -

MR PORTER-COOTE (H20): I have had lots of talks to the utilities and the utilities always say - Sydney Water, Canberra Water and those sort of things - "We can't recommend a particular product."

DR CRAIK: A particular brand.

MR PORTER-COOTE (H20): "We will put it out to tender," and then you would tender. However, since there's only one of these products available, there's some restrictions under the Trade Practices Act where someone can't be seen to be giving a commercial advantage to only one manufacturer. So it's a bit of a difficult question, the fact that I can licence the technology to another company and then they would compete, but they would still have to acknowledge it. But that's one of the problems, because it's a bit like with the water tanks, there are 50, 60, a hundred manufacturers of water tanks, so when they brought the rebate in, you didn't have to buy from one manufacturer, you could buy from whoever and get the rebate. But if they say, "We've got this item," and this item is the only one of its kind, they can't give us a competitive advantage.

DR CRAIK: Okay.

DR MUNDY: I think the competitive advantage is conferred by the patent though. I wouldn't necessarily accept a utility's view of what the Trade Practices Act or now the Competition and Consumer Act actually says. I find that a bit odd. There are lots of things that people market that they are the only supplier of and they do to government agencies; the military do it all the time, and civilian uses as well, so I think if you don't have independent legal advice, I wouldn't necessarily listen to the utilities. They may have some issues around their procurement rules which are imposed on themselves but I don't think it's an issue arising from the general Trade Practices law.

DR CRAIK: Okay. That's been very helpful and thanks very much for putting in your submission and coming along today. Thanks for answering the questions. I think it's a really interesting innovation.

DR MUNDY: I think it's a fantastic idea.

DR CRAIK: The fact that you say that the average insurance claim on water damage to properties is \$5000, that's a nice figure that I thought people would have been interested in.

MR PORTER-COOTE (H20): It's something which is new and different. Austrade had three people from America and all three people said, "We've seen lots of products here in Australia and we've seen lots of products in America and this is the first time we've seen something like this."

DR CRAIK: It's very impressive.

MR PORTER-COOTE (H20): It's Australian technology and we'd like to keep it as Australian technology.

DR CRAIK: Yes. Good luck is all I can say.

DR MUNDY: Yes, very good luck.

DR CRAIK: Yes, good luck and thank you very much for coming along. That was great.

MR PORTER-COOTE (H20): Thank you.

MR SULKOWSKI (H20): Thank you.

DR CRAIK: Our next person is David Allen. Thanks, David. Could you say your name and - - -

MR ALLEN (ARD): David Allen. What else?

DR CRAIK: - - - your organisation.

MR ALLEN: Australian River Deltas. That is a concept name, because we all know about the river deltas of the Mississippi, the Mekong. So many Australians don't know we have got river deltas in Australia, and they are a very important concept.

MS CRAIK: Thank you. If you'd like to make a few opening remarks, we'd very much welcome hearing from you.

MR ALLEN: My objective is to create more money and more jobs. I want to do that by having a more finely defined methodology, better defined matrix and something that looks actually at the supply and demand, because we can't talk about productivity unless we're actually producing things. What we're seeing in Australia is that productivity in some areas has gone down over the last decades. We don't manufacture much without urban water, we don't produce much food without urban water, and it's difficult to say anything other than that productivity has been going down.

I have had quite a bit of success with what I've been doing. I think I've kept some uranium out of our waters, and that may be important in the future. I certainly believe I've kept a lot of thorium out of our waters. Perhaps we are keeping some pesticides out of our waters. That is a theme which I have got. I have had some success with the sewerage system. I took the long handle to that a few years ago, putting in a submission to Kevin Rudd's 2008 2020 vision for Australia, and we might be saving at least 500 million litres of water in Sydney alone, and in other capital cities.

We need to look at the definitions of what urban water is, and there's a whole lot of things. It's not just the actual water, it can also be the product. So we are in a sense urban water products ourselves, about 60 per cent of us is composed of urban water. Germany's biggest port is closer to Sydney than it is to Berlin. The definitions are important and the metrics are important. So we do need to get a combination of metrics which is going to work for Australia, and perhaps not so much for a country overseas.

We need to look at what the objectives are, and I have seen some objectives

which I wouldn't even grace with the name of being an objective, because they don't actually produce anything. Maybe everybody would like to swim in Sydney's waters again, but that's not an objective. If we have to put chlorine in there and kill some of our productive plants, I think that's a counterproductive objective. So what happens is if we get our objectives right, we get our methodology right, then what we should be doing is we should be producing benefits for our economy, not costs, which I think is what we have been doing, that should be giving us jobs.

Water is the most important asset we have got in Australia. It's the most important asset on this planet. There isn't much anywhere else. Without water, we don't have any economy, we don't have any society, there are no sociological benefits once the water has gone. We just need to look at it a bit more efficiently. I followed the terms of reference fairly closely, opportunities for efficiency gain. We look at the falling output, and that could be illustrated with a number of different metrics, and I just look at one because it's interesting.

Gold is maybe one representation of urban water. Orange had to choose a few years ago whether they wanted to keep putting water into the city - there wasn't much - or whether they were going to continue with the goldmining, and they continued with the goldmining and that turned out to be a wise decision in the longer term. I have made a bit of a focus of the general theory of employment and stuff like that by Mr John Maynard Keynes, and he talks about gold a little bit as well. He said that what happens with it is it gets accumulated into monasteries or - heaven forbid - it gets exported. The last thing we want to do with our gold is, apparently, export it. He does have alternatives.

There are an enormous number of ways we could measure falling output, and we can also measure rising costs. Desalination plants, which are terribly expensive, recycling plants, which are terribly expensive, they produce water which is equivalent to being distilled water, and in some instances the facilities didn't work terribly well, they had to be redesigned. We have produced some very large dams. Brisbane's Wivenhoe Dam is one example, and that almost destroyed Brisbane when the floods came. It didn't do the job it was meant to do, because the operating procedures weren't clear. So there was a loss of production for Brisbane by creating the Wivenhoe Dam in a certain period of time.

We had pretty much the same situation in Sydney yesterday, we had enormous rainfall, we put it into channels, we polluted it as much as we could - chemicals from the gardens, chemicals from the roads, whatever - and we put it off to sea, and it didn't do any good for our economy at all; whereas if we used our urban water wisely, the rain that falls out of the sky for nothing, we could be a lot wealthier than we are. What Peter Cullen said, just before he died, was that he had at least one international water expert coming past his desk every week and some of them might

have had good ideas, some of them would have been just lobbyists.

I brought a few things along on the cost of some items. I have got a letter from the Department of Fisheries saying that we spent about \$3.5 billion a year on putting pesticides into our water, much of it is unnecessary; much of it is very counterproductive, damaging for our health. We can be doing a lot better than we are doing. We have got a lot of wasted expenditure. For example, we just did a desal plant in Sydney, we put it in the wrong place, near a sewerage outlet, and that wasn't accepted by the public. So we don't think things through, we don't rationalise the way we do it.

With regard to opportunities to gain efficiency, one thing we need to do, we look at the social, economic and environmental aspects; we need to define what an economy is, and we don't really have a good definition of it. We get some clues out of the Bible that tells us, "Don't build your houses on the flood plains," for example, and we just ignore that. We get some clues from Mr Keynes' general theory of relativity, where he says that now with this great new age there will never be food shortages because people can import food from the northern hemisphere, or the southern hemisphere, depending where the food is growing, where the supply is.

Now, that's absolutely inappropriate for Australia. In the 1930s there was absolutely no need to import almost any food at all. So the general theory of Mr Keynes is the general theory for Britain, and it's not really the general theory for Australia. So if we want to talk about the economy, we have to say what an Australian economy is. Just another point from Mr Keynes is that we use some of our water for the purpose of war, he tells us exactly why people should go to war and - it's certainly not the reasons why Australia might go to war - it has to do with trade and trading advantage.

Opportunities to achieve efficiencies, there are a lot of things we could do, but we have to look at supply and demand. If we have got a falling demand for a certain product or if we see a product isn't being terribly beneficial for our economy, we should perhaps change to products which are in demand. For example, some native Australian food types are very much in demand. The bloke who exports them says demand is so strong, he just cannot meet the demand. Native fish, also a strong product, because the world's fishing resources have been overfished. There are problems with beef production in America, with diseases, I think you have read about those.

There are glorious opportunities for what we could do in Australia. So if you look at a work program, it really is undoing some of the damage that we have done. We should be creating business opportunities for Australia which are based on good science, good objectives, a good methodology, so we follow certain steps when we

are defining new water facilities, and we don't take shortcuts and we don't allow too many of these international experts to be talking to people like Peter Cullen, who I think was a very clever and a very good man, but it's just inappropriate they should be talking too much with him.

Water is the ultimate truth equaliser. If stuff we have done isn't true, isn't honest, doesn't work, if it's shoddy, water will show that up in a flash, and we saw that with the Queensland floods where quite large sections of Brisbane floated down the Brisbane River. Water is one of the sources of taxes which are put on colonised people. The great revolt against the British in America was based on a water tax which was the tea tax. The same thing happened in India, their revolt was based on the salt tax, which they got out of the water.

What we have got in Australia in something which I would like to call an e-coli tax. We have got a lot of water facilities that are built because our water, which was safe for tens of thousands of years, has suddenly got e-coli in it, and only from certain specified species. So the cows and the sheep can do what they like in the water, but other species can't.

The way this is put in the media, there's an article from the weekend, yesterday, by Germany, telling the world that cucumbers from Spain are killing people in Germany. You can understand that is a logical thing for them to say, they want to sell German cucumbers in Germany, whereas in Australia, we've got a similar article, saying, "My God, don't drink anything, don't eat any food that's been made with Australian water, which has been potentially poisoned by e-coli because you're all going to get sick." What do we do? We import food from all around the world from countries which have got standards which are far lower than ours. The quotation is, "What the eyes don't see, the heart doesn't grieve." It is absolutely hypocritical, contrary to Australia's interests and we just have to do better.

You can't stop progress. Everyone says we are making enormous progress. You can see with debt, a trillion dollars' worth of debt that people have got on their credit cards, that progress isn't terribly good. Even Einstein, who wasn't all that very clever with mathematics, would say that if you keep putting pesticides and poisons into the water, then you have to reduce productivity.

What we're doing in Australia is we're spending millions of dollars trying to save the whale, and according to the Scientific American, we are spending billions of dollars putting pesticides into the water, other acids into the water, and these, according to the Scientific American, are poisoning the food chain of the whale. So on one hand we are trying to save the whale, on the other hand, we are perhaps destroying the whale and perhaps the human species in the long run as well because, as the Scientific American says, a lot of our food is dependent on what comes out of

the water.

Priority areas: stop putting pesticides in the water, focus on producing things from Australian River Deltas which are productive and in demand. The most fertile land on the planet, when Charles Sturt went down there, according to him, was the Murray delta, the soil was as black as ebony, and we have turned it into a septic mess in just 200 years. We need to spend less and we need to be more constructive in what we do with our resources. So many benefits coming from it: better health. We've stopped putting DDT into our water, we've stopped putting Agent Orange into our water. The question is whether any of these products were allowed in Europe - certainly the governance rules that they have got in Europe are quite a lot stricter than we've got here.

We can benefit, we can make jobs, and what we have to do is, as a nation, maintain control of our own water resources because they are very important. What happens when we privatise something, when we introduce more competition, it gets taken over by companies which operate overseas and they don't follow any governance procedures at all. They can do what they like, when they like, they can meet who they like, whereas the premier of New South Wales was not even allowed to discuss the gem trader deal with her treasurer. That was a question asked in the gem trader inquiry. What happens when one of these utilities gets organised? You all know what the objective of a multinational company is. It is to service the interests of the shareholders, most of whom or many of whom may live overseas. They have got no interest in Australia. If these people are running our water as well as our electricity, as well as our telecommunications, as well as our health, then we don't have much to say about the way that our country as an entity is run.

I'm quite happy to have private ownership, Australian private ownership, and I'm quite happy that it works in combination with the government. I'm quite happy that we do things in a way which is ethical, which is transparent and which focuses on producing measurable objectives, increasing productivity, making Australia wealthy and producing Australian jobs.

DR CRAIK: Thank you. Thanks very much, David, for that. Could you start off just telling me a bit about Australian River Deltas, the organisation that you represent.

MR ALLEN (ARD): Australian River Deltas is just a trading name. I started doing things with water a few decades ago when I was living in Holland and everyone in Holland is interested in water because it's under sea level - it flooded in the 1930s, it almost flooded a couple of years later and they want to make their sea defences big enough and strong enough to withstand a hundred-year flood. I said, "Maybe the sea levels are rising a little bit faster." I had a small business

consultancy firm over in Holland. I did the same in Australia and Australian River Deltas, as I said, is just a concept name. It's a trading name and it is here to advertise this very important concept which Australians don't know much about.

We don't know much about our waters. I got to Liverpool; people in Liverpool cannot tell me in which direction the river runs. Authorities in Sydney cannot tell me in which direction our groundwater flows. We do not know much about our water systems and Australian River Deltas is perhaps going to fill that void to an extent.

DR CRAIK: Okay, thanks. You say in your submission that in 2009, you contributed towards a scheme to make sewerage systems more efficient, saving 500 million litres of water in Sydney alone. Could you just explain what you did, what your contribution was?

MR ALLEN (ARD): I put in a submission to every one of Kevin Rudd's categories for his 2020 vision and when I finished doing that, I put in two concrete submissions because I saw they weren't going anywhere. One was free public transport which would save Australia a lot of money and the second one was to reform our sewerage system because I said what we do, we take the best water on the planet out of the mountains, we pollute it and we flush it out to Sydney. So that was the submission. I wrote to councils, I spoke at different councils, I spoke to different experts about it and what happened, perhaps with the help of a bit of luck from an entertainment facility which was organised just down the road here where some people accidentally got a whole lot of concrete into the sewerage system, but we started cleaning up our sewerage system a couple of years later and what we did is we took all the 12-litre single-flush toilets from Sydney up to Katoomba, which is a quarter of all our toilets and replaced them with four-litre dual-flush toilets and that's about 500-million litres of water.

DR CRAIK: Okay.

MR ALLEN (ARD): I wrote to other councils as well. I haven't checked up but I know they were talking about this in Canberra and there was an article in the paper saying that Canberra has one large sewerage system in Parliament House; there might be efficiency gains in other cities as well as Sydney.

DR CRAIK: In our draft report, we've put a series of recommended reforms. Can we get your view about those recommended reforms? Do you think we've hit the nail on the head?

MR ALLEN (ARD): I was very short of time and I didn't put in as much - but I mean, the reforms - with the methodology which is used, because I see that as being very poor. I think we are spending too much money. I think there is some evidence

of fraud in the system. According to the Scientific American more than two decades ago, America spent over a trillion dollars reforming their water systems and what the Scientific American said is that their water system worked better than it did before they spent the first dime and we've got a similar situation in Australia.

What they've done in America, they are going back to some of the old ways. They're putting back the everglades. Of course the water - they can't get it from anywhere else, so that is a reform which they're doing in America. We're doing the same thing up in Cairns, we're putting in mangroves. I think we should go back to grassroots, looking at supply and demand, looking at what works and focusing on that and then we should also at the same time look to see what is super expensive and super inefficient, producing distilled water for people who live in Sydney, whereas the people who live in rural Australia and the people who live in the rest of the world will accept water which you can produce a lot more cheaply, I think that is a major reform.

We have to get the science right, the science has to be rational and the costs and the benefits need to be there. Now, we can look at the costs with all these desalination plants and things we've got in Sydney but there aren't any benefits. What do we produce? We don't produce anything with them. We've got people living here. We're turning Sydney, for example, into a concrete desert. It doesn't produce anything. There's bitumen, there's houses, there's this and there's that, lovely gardens or whatever, it doesn't produce anything. I think that is the major reform. The river deltas are there. They should be producing food and they could be producing other things on it - I'm not saying just focus on food but certainly food is one of the obvious things we can be producing. We're not going to start producing computers or maybe cars in Australia, competition from overseas is just too strong, but there are things we can be producing. We should look at the things which Australia can do well, we can do cheaply, we can do in a cost-effective way and we can actually satisfy a demand which is out there, and that is what has been lacking in the debate with water in Australia, urban water, rural water, any sort of water.

DR CRAIK: One comment you make in your submission is about Sydney pumping its sewage out to sea, treated sewage going out to sea. I think, rightly, you don't think that's the best way to deal with it. Do you have a view as to how it should be dealt with, sewage treatment in Sydney?

MR ALLEN (ARD): A lot of things are happening in a lot of different countries around the world and a lot of countries don't have access to the sea. They can't put their sewage out to sea. There are productive uses that we can make with our sewage. Every time somebody says, "We want to dispose of it inland somewhere, people are saying, "Hey, hey, hey, you're going to be killing people." With this e-coli tax we've got, you just can't do it. Even with the most sensible people in the

world, there are things we could be doing with our sewage which would be beneficial. We could use it in tree plantations. There are many things we could be doing. They wouldn't be impacting on the sensibility of Sydney, Australians, despite the fact, as I said before, we do import food from other countries who do use their sewage in a productive way and part of that productive way is food production.

DR CRAIK: Okay. Thanks very much for your very detailed submission and for coming along today and talking to us today, appreciate it. Thank you.

MR ALLEN (ARD): Thank you very much indeed.

DR CRAIK: Our next person to appear is Richard Tooth. Thanks very much. Could you for the record state your name and your organisation please, and if you'd like to make a few opening remarks, we'd be happy to hear from you.

DR TOOTH: Sure. My name is Richard Tooth. I work for a group called Sapere Research Group. I'm here on my own behalf and as for opening remarks, I probably don't have any. You have a draft submission that you received from myself and Hugh Sibly and I'm happy to respond to some questions on that. That was largely around pricing reform and security of supply.

DR CRAIK: Okay, thanks. I guess my first question was you obviously quote the example of Santa Barbara and their flexible pricing regime, particularly during the drought. As we understand it - and I think it said in the paper but it's a few weeks since I've read it - there were also restrictions as well as pricing changes at that time, so I guess the question is: is it possible in anyone's analysis to actually isolate the effects between restrictions and pricing in terms of the changed behaviour? How do you tell what occurred? Does it make it much different from what happened here in Australia when we're short of water and the restrictions and often prices changed a bit towards the end? So how do you separate out the factors?

DR TOOTH: Sure. A number of researchers have tried to separate out the effect of pricing restrictions and I don't think anyone has attempted to do that in the Santa Barbara case. I've spoken to the lead author of the paper that you would have received that's been around since 97 that looked at the Santa Barbara case and also people in the city of Santa Barbara themselves and they haven't attempted to isolate the effect of pricing restrictions. That said, a number of people have done that and I think the work that was recently done for Sydney Water effectively does that, so I sort of recommend that and I know the Productivity Commission has looked at that.

DR CRAIK: Yes. So in terms of Santa Barbara, it's not really possible to - - -

DR TOOTH: No, but when you look at the detail - and I can't remember exactly how much detail is in the public paper but when you look at that, the response they got was quite dramatic. They got about a 50 per cent reduction in demand which is, compared to what we've been able to achieve here in Australia, very, very significant indeed. That was price and restrictions and public education campaigns. Their restrictions were pretty severe too. They even included things like restaurants shall not serve water unless asked.

DR MUNDY: You wouldn't get away with that in the ACT. Just on that, the operation of quantitative restriction and effectively a price add-on, if you like, which is what - demand based management - looks a bit to me like the simultaneous

imposition of a tariff and a quota, and the commission has some history in these issues. Why is it different to that, because it's just a price restriction and a quantity restriction, in effect - well, a price add-on. It looks like a tariff and a quota and that literature is well understood, unless you're trying to unbundle carbon policies.

DR TOOTH: I hadn't thought about it until you had just posed the question as to the effect of the quota. My immediate reaction would be that generally we're controlling a quota and there's rights to those which then can be traded in a quota type of system in which you don't have any restrictions. So effectively restrictions apply to everybody and you can't effectively trade your way out of restrictions and that's a key issue with restrictions.

I should just add on to the Santa Barbara question, there was actually apparently quite a lot of discussion post the drought as to whether they should have just supplied rates, and a number of staff at the City of Santa Barbara felt that they should have just used rates, rather than restrictions and rates. I think the general feel - I think the rationale that was given was it seemed like it was more equitable to also impose the restrictions at the same time and it would have been sending the wrong signal if people were able to water their lawns during the drought-type situation, but still that sentiment remained.

DR CRAIK: Do you know what's happened since in Santa Barbara, because that was the 90s, I think, wasn't it?

DR TOOTH: Yes, that was 92. I spoke to them earlier this year and things have sort of steadied. They haven't gone through the same sort of drought. The water rates are higher than they were before the drought and in terms of volumetric rating, the overall bill was higher because they had to build a desalination plant - I believe they had to build a desalination plant. I'm not 100 per cent sure - - -

DR CRAIK: Wasn't that the one that's never been used?

DR TOOTH: I've heard that by rumour - I heard that second-hand - but I admit I don't know that for sure.

DR CRAIK: Yes. That's what we've heard, that they built the desal plant but it's never been used.

DR TOOTH: Yes. An important thing in this is that they didn't return - the returns to the water utility weren't any different, so even though they increased rates, they returned any increase in charges back to consumers through reduction of its charges which has the wonderful benefit of both stabilising the water utility's revenue, which is a key issue here in Australia for the water utilities, and also consumers, because if

you're a very low volume consumer during the drought, your bill would have gone down - I should say your bill would have gone down compared to the alternative. I think in some situations it would have gone down, but they still had to pay for the desalination plant.

DR CRAIK: Yes.

DR MUNDY: It's an interesting proposition, isn't it, that you're invited to pay for security of supply that you may actually place no value upon as an individual, if you go down that path; that people who got the higher bills may have actually preferred not to have had the - - -

DR TOOTH: Preferred not to have had the - - -

DR MUNDY: The desal plant.

DR TOOTH: Absolutely. I can't comment on whether that desalination plant was necessary or not. I mean, obviously ex post it, it sounds like it wasn't, but ex ante - - -

DR MUNDY: But there were people who were invited to pay for it who would have elected not to have paid for it, given the choice.

DR TOOTH: Yes, possibly.

DR MUNDY: So there's a welfare loss associated with it.

DR TOOTH: Possibly, yes.

DR CRAIK: You give in your submission an illustration on flexible pricing and the effect it has on water bills. Do you think that all consumers should face the same tariff structure? I mean, even if it's a flexible one, do you think they should have choice, different tariff structures, depending on their preferences? That's our view in our draft report that that would be good, if utilities could actually offer choices to people, a bit like they have in other parts of life as well. They could choose how much they want to pay and how much they want to use.

DR TOOTH: I can see pros and cons. As a consumer, I like simplicity. On the other hand, I'm very pro choice in letting consumers be able to choose. My gut feeling would be that if you did leave it to a full market solution, if consumers wanted choice, you would see choice occurring. My feeling on this is you probably end up with some default, standard type of offers and then you would probably get some fringe type of deals that might be applied and I suspect they would be more for

business-type customers.

DR MUNDY: But if you've got a utility, particularly a utility that's got a reasonably varied customer base, say, somewhere like Yarra Water, it's on an urban fringe, it's got a mixture of relatively dense, traditional sort of urban housing, there's two or three-acre blocks, those sorts of things, would you see any downside in a policy that said to Yarra, "Well, you just go out and talk to your customers and offer them a suite of tariffs that you think they might like, because if no-one takes them up, what's the problem?" You don't need contestability or competition between suppliers to get consumers to reveal their preference unless they're not able to reveal their preference.

DR TOOTH: I agree. To answer your question, I see very little downside on that. Yarra Valley is in the best position; they work hard to understand their customers.

DR MUNDY: There might not be much point to do it in the CBD of Sydney where it's very homogenous. But following on from that, I guess, what challenges do you think that poses for regulators, assuming we still have them?

DR TOOTH: The water utilities tend to better understand their customers than I would say the regulators do. That's an opinion I'd put forward, in talking to the water utilities. I think in terms of developing the rate structures, it's better off done by the water utilities. The regulators obviously have the problem of - - -

DR CRAIK: So you support that recommendation?

DR TOOTH: Yes.

DR CRAIK: You're about the only one today.

DR TOOTH: Obviously there is the problem around economic regulation which then leads to the question of how do you control price gouging effected by the water gouging? You could go via a revenue cap or, as you're sort of promoting, I guess, more of a monitoring type of regime.

DR MUNDY: That leads me to the question of why not a revenue cap? Do you see any benefits in this individual setting of tariffs as opposed to - we can discover gouging with some sort of price cap. We can prevent gouging with a price cap, we know that. So do you have a sense of what additional benefits the community gets from these intrinsic price-setting arrangements?

DR TOOTH: I think it's caused a lot of harm historically. The question is, going forward, is there benefit as it goes on?

DR MUNDY: I think we were saying a revenue cap arrangement which is - - -

DR TOOTH: It has been debated between water utilities and regulators before. I've seen the discussion on those debates and I've seen a regulator where they have actually said no to a revenue cap arrangement and I've got to admit, I remember at the time not feeling convinced by the argument. I assume there would be some sort of issues in terms of when there's a variety of types of charges that might be - you know, there's variations in the times of products and charges, but I've got to admit, given the situation, I'd be erring on the side of a revenue cap.

DR MUNDY: Particularly given your observation that perhaps the utility knows more about the customers than the regulator.

DR TOOTH: Yes.

DR CRAIK: Do you think, under your notion of flexible pricing and scarcity pricing, do you think it would be possible for consumers to have a range of choices under that sort of pricing regime or would that be just too difficult?

DR TOOTH: I can't see why it would be too difficult. It's not too dissimilar to, say the home loan market, where you effectively have variable and fixed rate home loans. One of the challenges is that - I guess it's the same with the home loan market - you don't really know when a drought is going to occur, whereas I guess interest rates tend to move a little bit more frequently, say, than the availability of supplies do.

DR CRAIK: But you'd have a fair idea of what's going to happen with availability of supply - I mean, a drought doesn't occur tomorrow, a drought goes over a period of years and years. You could know how much water you've got and when you're going to run out.

DR TOOTH: I guess I am sort of thinking on the go here. It's I guess that forward sort of contract: what do you do when someone starts to apply it during the middle of a drought or when there is an excess? So I guess with home loans, you're contracting for a forward and fair period of time, whereas you might not do that under a water utilities operation, I guess. That said, I don't think those problems would be insurmountable, so I can't see why you wouldn't be able to offer people choice and I'm sure a lot of people would like to get the certainty.

DR CRAIK: Okay. You suggest that we perhaps shouldn't be too hasty about dismissing the prospect of a decentralised competitive urban water market. Do you want to elaborate on that?

DR TOOTH: Yes, sure. I guess my main concern there is that at some point, water will start to look like - I think the big issue with the decentralised water market is the security of supply problem. This is a problem that the industry needs to tackle head on. I don't believe to date the industry really has tackled this head on and truly understands the issue around security of supply. You can talk of security of supply in a whole bunch of different commodities. Some countries worry about security of supply of food, but I don't think governments here worry about a city running out of food. At some point, when you get a sufficient diversity of different sources or sufficient confidence in your different suppliers, water starts to look like food. At that point of time, do you say, "Let's stop trying to control this and let's use the power of the market?" So we need these sort of frameworks working when - and what is that point? That point might exist for quite a number of water systems right now and I can imagine there are certainties in some systems where you certainly wouldn't want to leave it to the market, but there are other markets where perhaps you have got sufficient diversity that you can.

DR CRAIK: Do you have any thoughts as to where that might exist at the moment, where you have might have - - -

DR TOOTH: The places which are connected to the Murray-Darling Basin where you've effectively got water markets now, you effectively do have a bulk water market there that you do have access to.

DR CRAIK: But if you have a severe drought, like we did, and it was worse next time around, would - - -

DR TOOTH: Prices would go up.

DR CRAIK: Prices would go up.

DR TOOTH: And if you had the flexibility of the contracts with consumers, then you could have arrangements such that the consumers are very nicely protected.

DR CRAIK: But not everywhere is connected, I suppose.

DR TOOTH: Not everywhere is connected and certainly - and I suspect in a city like Sydney - we don't yet have the diversity of supply and you would be worried. I think the other huge issue here is regulatory risk. One of the reasons why you would go for a liberalised bulk water market is that you would be sending a signal to suppliers for efficient investment. But would you ever invest if you were concerned that there was a risk that a government might change policy to enable more cheaper supplies to come flooding into the market?

DR MUNDY: Or whether you would suddenly discover the ability to set prices disappeared.

DR TOOTH: Yes.

DR MUNDY: The problem you identify is really not an unusual problem in a capital-intensive industry where supply conditions will be relatively slack over large ranges of output. But at some point capacity starts to approach utilisation and it's not a function of water. We saw it, for example, where airports have large amounts of service capacity and then a capacity constraint bites and all hell breaks loose because the prices have got to go up. So how do you manage that? If you don't have a set of pricing arrangements that reflect incremental costs, in some sense, you will reach that point - and it's not efficient to have the capacity sitting there waiting - so you still either run into a problem of higher than necessary current replacement pricing or a massive price disjunction when the capacity is due through, and whether you can hook it up to the Murray-Darling or not, that's assuming it's the next best option, and you've got to pump the water up and over a hill down the other side. How do you deal with those issues?

DR TOOTH: I guess there's a couple of issues in there. Really what you're describing is an issue of where the prices change significantly. You can still get quite an efficient outcome, and you can be quite efficient and prices will rise, in which case again from a consumer's point of view, fixed charges, if you implemented this, would come down. But it's quite efficient that prices could rise and that would therefore pay for the capacity. Effectively then, given the uncertainty, the additional capacity effectively becomes like an insurance policy. That can be quite efficient but the problems that start to emerge - and it ends up being a political issue - is that the price is rising, the risk that prices will be capped by governments, maybe other sorts of social disorders that you might see. If those price rises aren't significant, then you don't really have an issue. I guess the question is at what point do we think those price changes are significant? I think for something that was connected to the Murray-Darling Basin, I don't think the price changes would have been that significant during the drought.

As an indication, during the drought, the impact on food prices to the average consumer was way more significant than the impact on water. Having said that, the water charges are coming in now as opposed to perhaps at the time of the drought. So we did actually have price rises around food but we don't have that security of supply concern. Again, Warren, you were raising the issue around lumpy investments. The other thing with water of course is that water can be stored which helps to smooth lumpy investments which isn't the same with airports. That access capacity that you got early on - if you can't do anything with water, you can cheaply store.

DR CRAIK: Okay. Just back to this notion of decentralised markets, do you think there's any lessons to be learned from the electricity sector in terms of concerns about investment capacity that we can learn from the electricity sector that apply to the urban water sector?

DR TOOTH: I don't have enough expertise in the electricity industry to fully comment on that. I have gone through the literature around security of supply around the electricity industry and there are some parallels but there are also some differences. I think that's a very useful exercise that needs to be done, and actually that's what I'd love to see, a recommendation from the PC that this issue needs to be investigated; also, looking at other commodities like electricity and food.

DR CRAIK: Do you think it's salutary that nowhere in the world is there a decentralised competitive urban water market?

DR TOOTH: I guess there's a couple of things that are happening. Of course you do have water markets in rural-type areas but - - -

DR CRAIK: I'm talking about urban.

DR TOOTH: Yes. A couple of things are happening; one is that we are greater diversity. At some point we could have said this around some other commodities when the controls have been relaxed. Things are changing because we are getting greater diversification. Things are changing because we have better pricing capabilities. Back in the 60s and 70s, we didn't have metering; now you've got the option of price. There's actually a benefit that you can use. It's obviously concerning but I think we need to sort of looking forward to the future on this. I guess that's the main thing: I don't think any of us would ever expect that we would jump to liberalised markets, but I think the main thing is that we recognise that there is a power to liberalise markets and we want to make sure that we're not blocking off an option which has potential value.

DR CRAIK: Given the recent activity we've seen, we have some proposals which is urban water utilities setting prices and clarifying roles and responsibilities of the various players in the urban water sector, separating out the roles of elected representatives from utilities and the other organisations that are involved. Some of the recent activity we've seen in that sphere in a number of states in Australia, we've seen political interventions in relation to augmentation and pricing and things like that recently. I guess the notion of a decentralised competitive urban water market where the roles of various players would need to be even more clearly - - -

DR TOOTH: Yes, I think the benefit is that you would be forced to make it very,

very clear and I think that was part of the problem, which gets back to this issue around security of supply. Why do we get the political intervention? I'm guessing because there wasn't confidence that we really had security of supply under control.

DR MUNDY: When the AWA spoke to us earlier this morning, whilst providing some guarded support for further separation within the industry, they expressed some concerns about how systemwide planning would occur, and even in very decentralised markets such as electricity, there are still network planners. Some agents are entity charged - would you see that necessary in the sort of decentralised water markets that you have in mind?

DR TOOTH: I think there's still certainly a role for a grid manager because it's not exactly the same as electricity but you do need to manage where the different water sources are coming from and as a result - I mean, if you did use pricing to its full extent, you would have - you know, price is a different part of the network.

DR MUNDY: So that's the equivalent of effectively organising dispatch from day to day, but NEMMCO - or whatever it's called this week - had an investment planning - they used to issue a statement of opportunities, things like that. Would you see that sort of role as necessary as well?

DR TOOTH: You effectively could end up with a very decentralised sort of - whereas rather than a statement of opportunities, it's basically saying, "Here is basically what the price of water is going to be," and then you allow people to participate.

DR MUNDY: But we do that in electricity now and we still need that sort of entity to make it work. So with a product that's certainly less homogenous and, as was pointed out to us, can change its characteristics, whereas electricity is essentially electricity, I would have thought something like a NEMMCO or a network planner that's concerned about balancing supply and demand in the medium term would have been more essential than less.

DR TOOTH: Yes, I guess I'm not sure whether - I certainly believe that because you've got the different characteristics of different water sources - you know, I understand even when you've got desalination, you want to be careful with your mix because customers, even though there's no difference in the quality, perceive the difference. They can actually taste the differences in water sources. So you do actually need to manage the different sources carefully. But I'm not sure if it's so much a case of balancing supply and demand per se but actually just in making sure it's managing the mix. So I think you can use price to more do the balancing than supply and demand. I think an advantage of again the pricing is that you allow those small localised solutions as well because effectively the central planner has the

challenge of if you needed to work out which is the next source of supply, how do you collect all the information and all the possible supply sources, whereas the beauty about a price is that it sends a signal to all the potential suppliers. They can be very, very localised as to the viability of their little solution.

DR MUNDY: That's precisely the problem that small-scale solar voltaic is now causing for some electricity users; there's too many of them and perhaps the price ain't right.

DR CRAIK: Okay. I haven't got any more questions. Thanks very much, Richard. Thanks for your submission and we look forward to your final.

DR TOOTH: Thank you.

DR CRAIK: The last person appearing today is Sascha Moege from the Local Government and Shires Association. Sascha, if you could say your name and organisation for the record, and if you would like to make a few introductory remarks, that would be great.

MR MOEGE (LGSA): Yes, I'm Sascha Moege. I'm senior policy officer at the Local Government and Shires Association of New South Wales. I would like to make a few comments on our submission to your draft report and thank you for the opportunity to do so and open at the hearing.

DR CRAIK: Thank you.

MR MOEGE (LGSA): I guess the submission needs to be seen in context with the other two submissions we made, which comprehensively sets out generally our position and also the other initiatives by the Productivity Commission, for instance, the roundtable into regional water utilities which was quite beneficial.

Our submission mainly focuses on chapter 13 of your draft report which is about reform in regional Australia. I guess we would commend the commission for that sort of constructive analysis and support many of the conclusions in terms of structural reform; in particular, that that needs to be looked at on a case-by-case basis, particularly on aggregation of utilities, where costs and benefits are comprehensively analysed before a decision is made and also that different models are taken into consideration. We've already heard about county councils and alliances or regional corporations, council-owned regional corporations; all of those models are also supported by local government in some way or other.

We believe that your conclusions and recommendations in the chapter are very similar and also supportive of the inquiry that has taken place in New South Wales, the Gellatly-Armstrong inquiry which was a very comprehensive process and buy-in of local government in some sense. I think we would very much agree with your conclusion or recommendation that it's really a matter for the New South Wales government and for local government to go ahead with reform in New South Wales on the basis of that comprehensive inquiry and the recommendation of that inquiry.

Generally I think we also agree with your comments on drinking water quality. I think we would support the recommendation that health-related elements of the Australian Drinking Water Guidelines be mandatory. There's been changes to the Public Health Act New South Wales which will require, when the regulations take place, all water utilities to have quality assurance frameworks in place which basically is a similar process to the risk management process under the Drinking Water Guidelines. Finally, generally we would also agree with your

recommendation on funding of some sort of areas, locations or utilities where it's uneconomical to actually deliver the desired levels of service, and we've heard a lot about regional western New South Wales or parts of Queensland I guess where there are capacity issues, people can't pay, and so the utility cannot recover all their costs, so there will be a case for state government subsidies on an ongoing basis.

More specifically, I want to make three comments in relation to our submission. The first one is on the report prepared by AECOM Consultants for Infrastructure Australia. We've heard already about it. I would like to emphasise again our concerns with that report. We don't believe that is a credible report and we believe it should not be used in any sort of policy analysis or development work. The AECOM report actually contains a number of factual errors. It has conclusions in it that are not really based on evidence but just based on some anecdotal evidence perhaps that was submitted and without verification given to the consultants. We also don't think that the conclusions on the governance or structural framework for utilities is based on sound analysis. As a general criticism, the whole AECOM Consultants report is based on I think New South Wales town profiles which were selected as problematic towns, and conclusions are drawn from a small sample for the whole sector basically, for all regional water utilities. We don't believe that's proper policy work. It's also not really credible because of the process that has been put in place for the consultancy report. I think Infrastructure Australia has asked for feedback on the report. We have made a submission and we haven't really heard anything about it yet. There is no indication as to how Infrastructure Australia wants to go ahead with all these submissions.

As we heard today, Infrastructure Australia has indicated that they are not going to make any corrections to the consultants' report. I think it would be probably fair to say that that's quite unprofessional to do so, to put out a consultants' report, ask for submissions which indicate that there are many factual errors in there, not a correct report but leave it in the public arena. So generally, we would urge the commission to be very careful when using that report. We would also ask you to not use that report and not have any citations or references to it in your final report because we don't think it's a good thing for that report to be on the public record.

In terms of cost recovery, there's an information request about that. I think the association would support the current framework that is in place. I think what the best-practice guidelines in New South Wales say is that full cost recovery requires the recovery of efficient costs of services provision, including an appropriate return on infrastructure capital.

As a minimum, full cost recovery is achieved if either the economic real rate of return or the return on assets equals or is greater than zero.

We think that provides sufficient flexibility for councils and probably reflects the capacity that is out there in regional areas and we would support that, particularly as we have heard today that, for instance, debt service costs are included in the cost recovery process. As an aside, I will probably make the comment: when you look at cost recovery, it's probably not necessarily sufficient to just look at the point of time of one year where councils report on their cost recovery but rather look at long-term projections in utilities' financial planning and whether that allows for full cost recovery. So probably a better analysis would be to look at that and see whether, in their financial and strategic planning, they aim for cost recovery and whether it can be achieved.

The last few comments I want to make are on aggregation and the recommendations that are in your draft report which are some little things, I guess, but the first one is the conclusion on aggregation on page 409 which says:

There is considerable scope for appropriate aggregation of regional water utilities to give rise to material, productive efficiencies for a significant number of local council water utilities.

There were two concerns we had with that. Firstly, it doesn't seem to really reflect the preceding discussions which was much more balanced in terms of how it looks at benefits and costs. We also don't really see whether the statement in terms of the number of utilities where material efficiencies could be achieved is supported by the preceding discussion because you don't really look at individual utilities and see whether there is scope for aggregation or look at whether the benefits would outweigh the costs, so I think there is something I guess we would be a bit concerned about.

The other thing we believe that is important in terms of aggregation is the comprehensive analysis of the cost of aggregation in your draft report, and we would really agree with that, but we believe that probably that should be put into a section that summarises the chapter - we haven't really found it in there - because, as you know, many people just look at the conclusion or the summary, and might want to see also that there are significant costs involved with aggregation. These are all the points I want to make.

MS CRAIK: Thanks very much, Sascha. I note your comments about the AECOM report, by the way. On the issue of full cost recovery and the Office of Water position and your response to that, that you think that's a reasonable approach to it, I guess two questions. Firstly, one of the submissions that we have had, which is I think from the water sharing group - anyway, they're a few New South Wales regional utilities - say that they don't and they can't aim for full cost recovery; it's actually in the submission. So they're actually quite specific in that, and I'm sure the

words are "don't and can't aim for full cost recovery". Given the nature of their constituents, I'd be interested in your response to it. That's the first question.

The second question really is your response to the Tasmanian economic regulator, who suggests that a real rate of return to reflect full cost recovery for water businesses is at around 7 per cent per year. The PC's previous conclusion - this is government trading enterprise, this is in our report, but a previous report a few years ago - is 5 to 6 per cent to be considered commercial. We know regional New South Wales water utilities probably don't want to be considered commercial, but that may be the OTTER comment. So I'd just be interested in your responses to those things.

MR MOEGE (LGSA): The first one in terms of full cost recovery, that's on utilities, I believe they can't achieve that. I mean, I guess that needs to be seen in relation to the finding and the conclusion you had in your report, that for some of them it's not economical to actually provide those desired levels of service. If you look at it from that perspective and if there's still state government funding required for some areas, then it probably would in some ways conflict with full cost recovery. I'm not aware of the group and who is included, but I could imagine - - -

MS CRAIK: Water sharing utilities. I can't remember the precise - - -

MR MUNDY: It's Narrabri, Moree and - - -

MS CRAIK: It's Moree Plains, Gwydir and WALGA. That's the three of them, yes.

MR MOEGE (LGSA): But I would imagine that's where they're coming from in a way, because that's really the concern of that, as you know. For some locations and some towns it's not economic to provide the desired levels. So if there's cross-subsidisation already of the utility, it has a number of towns, some of which are more expensive to service, others are not, some are bigger. So there's that issue, and you will have that issue in whatever instance and whatever structural arrangements you have in place. If you look at that particular location, you will always have that issue. It would be probably fair to say that in regional New South Wales many supply systems are quite isolated in a sense, particularly those which are little towns, so you can't really address that issue any other way. I would guess that would be the concern, if they make that statement.

MS CRAIK: So in terms of dealing with that and in terms of our report I suppose, there's some utility in identifying that there may be a reasonable number of small places where this is just not likely to be a practical exercise, full cost recovery, and other arrangements need to be considered.

MR MOEGE (LGSA): I would consider the arrangement of state government funding for these places - - -

MS CRAIK: Yes, under transparent CSOs.

MR MOEGE (LGSA): Which has been in place in a way already - - -

MR MUNDY: Because if they're not cost recovering, then it's either got to come out of the rate base or it has got to come from a higher level of government, because the money has got to be - well, alternatively, they just don't fund the depreciation and hope that there's a capital grant that comes along when something breaks.

MS CRAIK: So does the state government actually routinely kind of fund these organisations as a transparent CSO or is it kind of blurred through the rates funding it - you know, it's kind of cross-subsidising through the council, or grants here and there? I mean, is there a kind of structured process for doing this?

MR MOEGE (LGSA): I'm not completely aware of how councils or utilities would account for all of that, but, yes, the subsidies that are given to them by the state government under the country town water supply and sewerage program would support that particular fund and would remain in that water and sewerage fund and be used for the project they have applied for.

MS CRAIK: But that is a project-specific style of funding.

MR MOEGE (LGSA): Yes, it would be a water treatment plant or something, yes.

MS CRAIK: Yes, as opposed to ongoing - - -

MR MOEGE (LGSA): Yes, I think it's mainly capital funding for a particular project, not ongoing renewal funding or maintenance funding.

MS CRAIK: I understood that funding program had stopped.

MR MOEGE (LGSA): I think it's supposed to end in 2012-13, isn't it? No, I'm told it will be going to at least 2015-16, and it may go longer.

MR MUNDY: The general financial assistance grants that come to local authorities from Commonwealth, do they take - and I perish the thought of opening up anything that looks like a Grants Commission's process, but when funds are allocated between local general funding are the costs of water provision considered, or is it because they're separate and quarantined they're separate and quarantined?

MR MOEGE (LGSA): I'm not quite sure, but I think it's for the tax support, so for general government activities of councils.

MR MUNDY: Okay.

MR MOEGE (LGSA): So as the water and sewerage fund is really ringfenced in terms of revenue earned, in terms of expenditure, it wouldn't really be considered.

MR MUNDY: Can I just bring you back to the question of drinking water quality and your indication that you generally support what we were saying about making those mandatory, and I appreciate that New South Wales has altered its legislation. One of the other recommendations that we made was that notions of personal liability which extend to directors and councillors and people like that in some jurisdictions, with respect to for example occupational health and safety issues and going ultimately potentially to the issues of corporate manslaughter.

One of the suggestions we made in the report was that some consideration be given to making those very human safety, critical elements of the water supply, attaching personal liability to those in charge of those utilities, was one of the other observations we made. Is that something that you would support or is that something you might discover your councillor members would be a little bit concerned about?

MR MOEGE (LGSA): I really would have to take that on notice. I couldn't make a comment on that.

MR MUNDY: Because in New South Wales directors are personally liable for certain industrial accidents, and one of our considerations is, well, you should exercise the same duty of care about the quality of water you put in people's homes.

MR MOEGE (LGSA): Councillors are democratically elected people, so there's a bit of a difference to a board in that sense.

MR MUNDY: It applies to councils supervising works.

MR MOEGE (LGSA): Yes, it does, in a way. I'm not an expert in that governance, how the arrangements are at the moment and the Local Government Act, but I guess there would be some accountability.

MS CRAIK: Armstrong-Gellatly report, have you got any indication from the new government as to if or when they might respond to that?

MR MOEGE (LGSA): No, I don't have any indication yet. I believe as there is a new government in New South Wales now - we are just starting to meet with the

ministers - it's high on the agenda. I think actually there's a meeting today with the minister, Minister Hodgkinson. So that will be on the agenda, but, no, I don't have any indication. But I must say that the Office of Water is working on a response in essence by review and considering the best practice management arrangements, and the introduction of the new Public Health Act is another step into implementing those recommendations, in terms of drinking water quality.

MS CRAIK: Do you support all of the recommendations, including the 32 groupings in that Armstrong-Gellatly report?

MR MOEGE (LGSA): From memory, I don't think we had a particular view on that 32. I think from our perspective it would be up to councils to find the right grouping.

MS CRAIK: Okay, so much the same as we - - -

MR MUNDY: So much the same, you support the processes - - -

MR MOEGE (LGSA): Yes, we're very similar.

MR MUNDY: You support the notions, but - - -

MR MOEGE (LGSA): Yes, but we were not firm on the 32, no.

MS CRAIK: We didn't make a landing on the 32 either. We support the process. Thanks.

MR MUNDY: I think our notion of aggregation extends across a broad range of structural forms from voluntary alliances at one end - and perhaps we're becoming a bit more indifferent, but people seem to be doing things. On the point you make about the cost of these aggregation arrangements, I would have thought - it's a bit like revealed preference theory - the fact that people are doing them means that the benefits outweigh the cost. Is that a reasonable summation? Someone showed us a map before and a very large part of New South Wales had a few coloured blocks on it, which, to me, looked like aggregation was occurring, perhaps not in the way that some would prefer, but it's certainly happening, progress is being made.

MR MOEGE (LGSA): My comment on that would be that the model we have put forward, the regional alliance model, actually avoids certain costs of aggregation, which is the important point we have been making throughout our submissions, which is the two costs, the economies of scope that occur within council if the water and sewerage business remains in council, which is all the technical administrative efficiencies you can achieve from delivering a number of services to the community

and not separating them all out; and the other cost that is being avoided is the cost that is associated with not being able to undertake integrated water cycle management.

We have heard it today, councils do stormwater, land use planning and they deliver water supply and sewerage. So they are actually able to deliver a truly integrated approach, if they wish to do so, and if they do it. That's the other cost that we see in terms of aggregation under the regional alliance model, because the water and sewerage business remains within the councils that are part of the alliance. However there is a bit of resource sharing going on and there is ideally a bit of strategic direction, like a Lower Macquarie Water Utilities Alliance where they do a regional integrated water cycle plan or regional drinking water quality.

So there is this kind of strategic support as well. So those are two things we think are quite important and do achieve a lot of benefits from aggregation through that, the skill-sharing benefit and also the strategic planning benefit, if you do it properly, but you avoid the cost of losing those economies of scope within council and you avoid the cost then associated with not being able to do integrated water cycle management.

MS CRAIK: Is there a worry though that a council might withdraw from a voluntary alliance, particularly of one of the bigger ones that's providing a fair bit of the wherewithal for the alliance to actually happen? Say, if a new regime comes in, "Well, no, we don't want to do that any more, we want this money for something else," is that a worry?

MR MOEGE (LGSA): It's a fair question I guess.

MR MUNDY: What happens if Dubbo - - -

MR MOEGE (LGSA): That's right.

MS CRAIK: I wasn't going to say Dubbo, because Stewart was still sitting here.

MR MUNDY: Not saying he would, but - - -

MR MOEGE (LGSA): From the association's point of view, we think that the benefits that you have from doing those regional alliances would have people continuing to do it. So we believe in that process, and that process might lead to new things that they discover when they go through the process. So we have put in our submission many times that it should be really up to the councils and the alliance to decide how binding they want to have it, how much functions they want to give to the alliance. So there's I guess an evolutionary process that you could have in mind

in terms of how that develops. As long as there are benefits, councils will continue to do it.

DR CRAIK: I'm just worried it might end up in the lap of the United Nations.

MR McLEOD (NSWWD): If I could, I was involved in the LGSA submission to Gellatly and Armstrong and our intention has always been - - -

DR CRAIK: Stewart, could you come up? I know this is slightly irregular but could you come up to the microphone and announce who you are for the record and then - - -

DR MUNDY: And we don't let everyone do this, only people we like.

MR McLEOD (NSWWD): Yes, thank you, madam chair. Stewart McLeod, chair of the Water Directorate and a member of the LGSA Office of Water liaison committee. When the original LGSA submission went into the Gellatly-Armstrong report, the model that we put forward was more than just the voluntary alliance. We always called it a mandatory alliance where the government - or somehow or other there had to be a way of mandating membership of it. But once you created the alliance, you couldn't just drift in and out of it at will. I think that still needs to be negotiated with the Office of Water and the state government that (a) you're probably going to have to force some councils into alliances to start with because there are a certain number of councils who, often for historic or personality reasons, just don't get on, but somehow or other, to get the advantages of aggregation, some people are going to have to be told to be in alliances. Then once the alliances are up and running, you are dead right; you don't want a big council pulling out, nor do you want a small council pulling out who most needs the benefits.

DR MUNDY: So, say, for example, the alliance that your council is part of, is there an impediment to the alliance being structured in such a way that if you join it, you're giving commitments to others which you can be bound? Membership is voluntary but once you join the club, there are some obligations attached to staying. Now, I accept that that might not be the way they're currently drafted but is there anything in law that stops the members of an alliance basically saying, "If you want to join the alliance, you're bound to it"?

MR McLEOD (NSWWD): That's probably what our deed of agreement says now, but if it came to it and a council said they were pulling out, the other seven members are not likely to take them to a court and tell them - you know, some sort of sanction. But if somehow or other the New South Wales minister for water had a say in the way those alliances were operating, you really do need - what we don't have at the moment is some sort of dispute resolution process which is a stepped process which

eventually ends up getting either to the commissioner of water or the minister, who eventually has the power to say, "No, you've got to stay within the alliance."

DR MUNDY: The members of the alliance could construct such a process if they felt they had a need and there's plenty of arrangements - and the alliance, it strikes me, is essentially a contract between consenting parties.

MR McLEOD (NSWWD): It is, yes.

DR MUNDY: So the parties could come to a dispute resolution which may not involve - ministers tend not to come to disputes with clean eyes.

MR McLEOD (NSWWD): Sure.

DR MUNDY: But independent arbiters do and - - -

MR McLEOD (NSWWD): Yes, that is our intention. The agreement we have now is only three years old and we've been busy actually doing the stuff. We are working on an improved agreement, but we really need to get the reform process for New South Wales announced and finished. Yes, I saw a dispute process where it was a stepped process where you initially do it in-house and then maybe you go to an independent arbiter and then maybe there's a government tribunal and then maybe after that there's a minister who eventually has to decide something. But you would structure it so that you hoped you'd never have to go to the minister.

DR CRAIK: The way the Murray-Darling Basin Commission did that was that the final arbiter was the chief justice of the State of Tasmania, so no-one in the Murray-Darling Basin Commission - - -

MR McLEOD (NSWWD): We'll take your advice on that.

DR MUNDY: What, was the chief justice of Western Australia not available? Can I just come back to something Sascha was saying - thanks for that, that was very helpful, Stewart.

DR CRAIK: Yes, thanks for that.

DR MUNDY: You were talking about there was a range of - that there was no rigid structure for alliances and they do the things that the people who are in them want to do. Does that mean you just see - and a logical extension of that notion is, really, a county council is just a particular form of that, a long spectrum, and it's perhaps at one end of it. Is that the way you see it, by and large?

MR MOEGE (LGSA): I guess so, yes, in a way that could be right. If you look at it from a pure governance perspective, that would be the case. It's just some sort of shifting the governance arrangements a bit here and there. At what stage you have a joint decision-making body, which you can have an alliance - - -

DR MUNDY: The county council is an organisation that owns - it's got legal form that owns things - - -

MR MOEGE (LGSA): Yes.

DR MUNDY: - - - whereas the alliance doesn't take possession from - - -

MR MOEGE (LGSA): It does not own the assets, that's right, or infrastructure. But theoretically it could, for instance, if council decided that in an alliance, they want to construct or build some regional infrastructure that is important to all those councils. They could set up a process where the formal entity will own that regional infrastructure theoretically.

DR MUNDY: This has been something I've been trying to tease out: why do you think people around Taree and those places have preferred that model - and we now see that Gloucester wants to hop into the game - why do you think they have preferred to go down that track rather than the alliance model?

MR MOEGE (LGSA): I'm not quite sure about that. I think Stewart alluded before in this presentation that the set-up of county councils was just something that happened 10, 15 years ago. I'm not quite sure whether - - -

DR CRAIK: As a result of the reforms that - - -

MR MOEGE (LGSA): As a result of a number of things.

DR MUNDY: A long time ago.

MR MOEGE (LGSA): I don't think there was a particular choice by the people.

DR MUNDY: It happened to be there.

MR MOEGE (LGSA): Yes.

DR MUNDY: It went into what it was doing at some point in time. It's there, it's a useful institutional form and people said, "Well, it does the job down the road, so I may as well join it because I've got to solve my problem."

MR McLEOD (NSWWD): I think the county council model, if I could jump in, it has dangers further west, that you really end up - and say it was a county council based in Dubbo - taking the resources out of the member councils that currently do water and sewer. They would end up centralised and back at Dubbo. The general purpose council for that reason basically ends up less viable. It would be similar to a regional corporation in effect.

DR CRAIK: Is that because the councils are so much relatively smaller than they are where the county councils that currently exist were created? Basically the towns are smaller.

MR McLEOD (NSWWD): Probably, yes. Four of the county councils that exist really - no, three of them only distribute bulk water. They're not - - -

DR CRAIK: They're not retail.

MR McLEOD (NSWWD): Yes.

DR CRAIK: Okay, interesting.

MR McLEOD (NSWWD): So I think county councils were the only model available. Like, Riverina County Council has been going for decades. I think Neil's county council might have only been 1996 but the other county councils existing - - -

DR MUNDY: I remember growing up in Sydney and the St George County Council was electricity - - -

MR McLEOD (NSWWD): I think they were always water but some of them would date back probably to post World War II. They are very - - -

DR MUNDY: Yes, I suspect that some of the country ones might have distributed electricity - - -

DR CRAIK: I think that was what Neil was saying.

DR MUNDY: Yes. Namoi certainly - the water was in the hands of the town council.

MR McLEOD (NSWWD): Yes, the danger that many councils that would favour an alliance would perceive is that creating a county council really generates the same job losses in their local town that a corporation would and whether it's fair or not, local government remembers the electricity industry started with county councils and the county councils got bigger and then they turned into state-owned corporations. I

guess - local government used to look after electricity, now they don't - they would see a county council as more likely to be the precursor of losing water and sewer.

DR CRAIK: So either a county council or a GTE - there would be the impact of the removal of the business and associated things from the county council.

MR McLEOD (NSWWD): Yes. MidCoast is a fairly small area.

DR MUNDY: And close together.

MR McLEOD (NSWWD): It obviously works. There could well be parts of New South Wales where the local councils might like that as an option, but where they don't want it, I don't think they want it forced on them.

DR CRAIK: Yes, okay. Moving on, because we haven't got too much more time - thanks for that - consumer advocacy, we want to see a greater role for consumers in supply augmentation and I guess tariff setting and pricing. Do you think there would be benefits from greater consumer input in regional water systems? Is that an issue in regional systems or do you think that councils are close enough anyway to the constituents that it's not such a big deal?

MR MOEGE (LGSA): Yes, I wouldn't think it's such a big deal there. The view of the association would be that through the democratic representation and closeness of the councillors, there would be enough accountability. On the other hand, there is a recommendation in the Gellatly-Armstrong report that councils should join the ombudsman's scheme in New South Wales to have complaint handling and these kinds of things in I guess a more standardised manner. The association has supported that notion but has basically also said that where councils already have other complaint mechanisms in place that are adequate, that should be supported as well, so there shouldn't be any sort of mandatory participation there, but there will be an opportunity for them to be available to them.

DR CRAIK: Okay. In terms of customer hardship, do all regional New South Wales service providers maintain a formal customer hardship policy?

MR MOEGE (LGSA): I'm not aware whether they all do. I'm sure some of them do have hardship policies. For instance, many councils have hardship policies for their rates, others don't.

DR CRAIK: Do you think it would be a good idea to have kind of at least a standard hardship clause if there isn't one?

MR MOEGE (LGSA): Yes, I think it would be a good idea, just good

decision-making, of course.

DR MUNDY: They all provide concessions for pensioners. Are they people in receipt of the pension, people who happen to have a card, DDA card, but if you happen to be unemployed, you're unlucky?

MR McLEOD (NSWWD): I'm not sure.

DR MUNDY: People on Newstart allowance - - -

MR McLEOD (NSWWD): You've got to be a pensioner.

DR MUNDY: So it's a function of the nature of your entitlement rather than a function of your need.

MR McLEOD (NSWWD): Yes.

DR CRAIK: How do customers and regional service providers deal with disputes? Do they just phone up the council and complain? Some have complaints systems, you've suggested, but as I understand it, the Energy and Water Ombudsman system in New South Wales isn't available to regional people, it's just urban. I think that's right.

MR MOEGE (LGSA): I think so. There was a recommendation that they join or that they can join it.

DR CRAIK: So if a council doesn't have a complaints system - - -

MR MOEGE (LGSA): Each council would have some sort of complaints system in place, where people could call the council and complain.

DR CRAIK: I suppose there's always a receptionist on the front desk.

MR MOEGE (LGSA): Yes, that's right.

DR CRAIK: But that's not really the complaints system, is it? That's just a person answering the phone.

MR MOEGE (LGSA): Yes. I think it would be fair to say that many of them are able to handle complaints in an appropriate way. If you have a small town, it's probably not such a difficult process, whereas if you're in Gosford or Wyong, you probably want to have a proper process in place just because of the scope of things.

MR McLEOD (NSWWD): At the other end of the scale, you do annually advertise your customer service levels, so there is the formal opportunity to approach the council each year and if you're outside of a service area, you can say you want to be inside the service area. If the council is guaranteeing a certain water pressure in your area, you have got the opportunity to say, "That's not enough," or, "It is enough." So there is a proactive side of it as well as a reactive - - -

DR MUNDY: There are some areas in which people in regional New South Wales have more rights and more consultation than the residents of Sydney.

MR McLEOD (NSWWD): There would be a lot of things we do better than - - -

DR MUNDY: I don't imagine they're consulted on their water pressure.

DR CRAIK: I imagine that's right. Who sets the water pressure levels, you guys or - - -

MR McLEOD (NSWWD): The local water utility but we do so within accepted industry standards. That's normally the WSAA codes or the old Public Works Department standards which have been updated by our Water Directorate guidelines, for instance.

DR MUNDY: So, Stewart, there's a range or there's a minimum, and if people feel they need more, then there's a discussion about costs and things like that?

MR McLEOD (NSWWD): Yes, usually there is a minimum and a maximum set but each council will choose its own, probably to suit the historical nature of its own network.

DR CRAIK: Developer charges, just to finish off, do you think - I mean, there's something in your submission, Sascha, that says the association supports the concept of developer charges as an economically efficient and equitable financing mechanism for public infrastructure and then goes on to detail how they are levied. Do you think the current developer charges provide adequate signals in the cost of servicing new developments and do they achieve equitable and efficient outcomes?

MR MOEGE (LGSA): I guess what we put in our submission is that just providing the information and probably indicating that there is a framework available that councils can use and utilities can use to levy developer charges. I believe it's also possible to have different developer charges for different areas.

DR CRAIK: Within a - - -

MR MOEGE (LGSA): Within a utility.

DR CRAIK: Yes.

MR MOEGE (LGSA): Council have - for different developments they have to prepare development service, servicing plans, which basically sets out design parameters and standards and also the cost in terms of delivering or the cost of that infrastructure that's required for that particular development or shared infrastructure. So I guess the policy framework would be in place to send adequate signals. I think many councils would, for simplicity reasons, choose to have a developer charge for the whole area but I couldn't make a comment on how that actually works out in practice. I'll have to - information available, on hand at the moment.

DR CRAIK: Okay. No, that's fine, thanks. Okay, well, I don't have anything - - -

DR MUNDY: No, that's all very helpful indeed.

DR CRAIK: No. Thanks very much for that. Thanks, Sascha.

MR MOEGE: Thank you.

DR CRAIK: And thanks Stewart, for that. Okay, now - - -

MR McLEOD (NSWWD): I hope you didn't mind.

DR CRAIK: Now, that concludes today's scheduled proceedings, but for the record is there anyone else who would like to appear before the commission today? Sam, would you like to come up and say your name and if you have a few brief remarks?

MR SAMRA (NSWOOW): Thank you, Madam Chair. Sam Samra, senior manager, water utility performance, from the New South Wales Office of Water.

I'd just like to mainly clarify a few of the issues that were raised today, just going quickly through them. Developer charges. In New South Wales we have comprehensive guidelines for water and sewage developer charges, and a copy of these guidelines have been provided to the commission. They are basically based on obtaining full net costs recovery from new development for the costs of servicing them.

Secondly, with regard to remote communities obviously these are very expensive to serve and I'd just like to refer to the National Handbook for Affordable Water Supply and Sewerage for Small Communities which looks at having appropriate levels of service and standards for such communities, and those are routinely used in New South Wales for serving such communities because of the huge capital costs per property of serving those. For example, for a small town, typically the capital cost per property is over three times that for a place like Dubbo.

With regard to the operation maintenance cost for Sydney I would just like to note for the record that the national performance report 2008-9 notes that the operating costs for Sydney for 2007 and 2008 were affected by the defined benefit superannuation scheme, and that was the main reason for the big jump there. The underlying costs weren't actually changed from previous years, and page 85 of the report notes that.

Full costs recovery has been discussed a number of times today. I would just like to clarify the definition the Office of Water has been using is in accordance with the national water initiative's "lower bound pricing". So essentially - in short you can obtain lower bound pricing for a water - for a sewerage system on the basis of being able to fund a renewals annuity. In practice that - you know, some calculations we've done - typically that means something like an economic rate of return of about minus .5 or around that sort of mark is what the analysis for a couple of systems has shown as the equivalent of what's required for a renewals annuity where the concept is that you maintain the service to that community at present standards and to continue funding that indefinitely; so in terms of assuredness of providing supply.

As you've indicated in the performance reporting basically 91 per cent of the utilities in New South Wales have now completed a strategic business plan and

financial plan, and that's the main planning tool for the utility to demonstrate to us that they have examined their future and that they are setting their revenue and bills to meet their long-term requirements. So we're not too worried if in one year their revenue drops just below zero so long as they've got their business plan, financial plan and they're operating to that. Basically a signal that they are actually doing that is where in a particular year they've now got a result of negative real rate of return of about minus one, and that's quite common during the drought as a result of the drought restrictions and the reductions in water use. So if the utility then responds to that and it applies a significant increase to their price, then that's the signal that we recognise that they are not asleep at the wheel and they're responding to the reality, and that's why we're giving them, basically, substantively deemed full cost recovery in the performance reporting.

DR CRAIK: Sam, can I just ask you in relation to that one, do you go back and look at the last, say, five years of a particular utility and look at what economic real rate of return they got and just see - you know, so you give them a tick for this year, but if you look at the previous five years, it's been the same story.

MR SAMRA (NSWOOW): The stand on that, we've been proactive, we've actually released that new, circular LW11, which goes through the full cost recovery process in a lot of detail to provide better guidance to the utilities on how to set their price on an evidence basis and, essentially, be much more assured of getting full cost recovery, certainly across a period of years. Obviously, in any one year, it could be a very wet year, no-one uses any water, it could be drought with severe restrictions and, therefore, again, you sell less water. Those two things are the exception. If a utility is working under the orders of this business plan, then they're really under quite good control.

The 30-year financial plan that goes with the strategic business plan is our main regulatory tool, basically, and then, obviously, the economic rate of return is the backward-looking thing. In terms of the assets employed, it's not looking forward. You may need to send \$50 million next year and that doesn't show up at all in the economic rate of return stuff, but it does in the financial plan. That's obviously a more powerful tool and that's why we give credit to the utility for significantly increasing its prices in order to recover all its costs. That's why they get, effectively, a full cost recovery indicated.

It was mentioned this morning that some utilities responsible in some councils for water and sewerage might be overcharging the water and sewerage services for things like the cost of a depot, and I just want to record that, under the best-practice management guidelines, if a utility wants to pay a dividend from the surplus of the water and sewerage businesses to the council's general revenue, they've got to obtain an independent auditor's report that reviews their allocation of costs and determines

that the allocation of costs are fair and reasonable and that the water and sewerage services aren't being overcharged. Any of the utilities that are paying a dividend have already got such certification, which has been reviewed by the Office of Water, and therefore they are allowed to pay the dividend.

The other one just regarding, again, county councils. In short, most of them, basically, were formed around the 1930s. The underlying quality is that they were regional water supply systems that covered broad regional areas. They were all basically liked that, including MidCoast Council, which, basically, serviced the areas of Greater Taree and Great Lakes. The underlying reason was that they are a regional water supply scheme serving that area, and that was why they were formed as a county council back in the 1930s. So it was really prior to form, but it was just as an efficient way of running the system. The system we've got now is that, when we're considering aggregating utilities, there'll be - in terms of managing the physical water supply and sewerage systems, typically they'll be separated by about 50 kilometres, so there'll be no way you can interconnect them. But, obviously, if you did have aggregation administratively, you can have one body in charge. Whereas the distinction for the historical county councils, they all had one contiguous water supply system.

DR CRAIK: Yes, that helped. That's very helpful.

DR MUNDY: That's helpful.

DR CRAIK: Yes, thank you.

MR SAMRA (NSWOOW): The other one, EWON. I'd just like to record that, basically, EWON has indicated they're willing to have councils join them as members, and Shoalhaven Council has joined them. So EWON very happy to receive country councils as members. The final point is just under the broad heading of Efficiency of Service Provision. I'd just like to note that the 2008/9 performance-monitoring report notes that:

The statewide median water supply and sewerage typical residential bill has increased by two per cent in real terms over the last 14 years.

To me, I think, if you want a broad signal of efficient service provision, that's an indicator.

DR MUNDY: Can I just ask one thing of you. If you have a relatively simple work example of how these renewals annuities are being set up, just so we can understand the categories of things. Because part of the discussion is, "What's in it, and what's not," and if you guys have something that you can just send to us, so that we could

just have a look at it, rather than trying to explain it words, because it's a lot easier to see on a spreadsheet if we're doing an annuity calculation. That would be really helpful.

MR SAMRA (NSWOOW): Yes. Actually, in practice we don't bother doing renewals in New South Wales, because the present requirement is the utility has got to do a 30-year financial plan of all its recurrent and capital expenditure, and so we analyse that and from that plan we say, "Okay, annual renewal required is \$10 million, the stipulate that will be required is \$400 in current dollars." To us that's what convinces us that they know where they're going.

DR CRAIK: Thank you. Thanks very much, Sam. That concludes today's proceedings and the commission will resume in Brisbane tomorrow.

AT 3.26 THE INQUIRY WAS ADJOURNED UNTIL
WEDNESDAY, 1 JUNE 2011