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Mr David Crawford
Acting President
National Competition Council
GPO Box 250B
MELBOURNE VIC 3001

Dear Mr Crawford,

Request for an investigation into the business practices of SA Water and the State Government of South Australia

SA Water, as an arm of the government of the State of South Australia, is failing to deliver the water and sewerage services as required by its legislation and its charter. A major cause of this dilemma is the extraction, by the State Government of 78.8 % of the after tax profit, as a dividend, leaving SA Water unable to fund the programs it may in fact want to deliver. This dividend is set to increase to 95%.

I believe SA Water and the government of the State of South Australia are breaching the competition provisions of the Commonwealth Trade Practices Act by restricting competition through the use of their monopoly position to prevent new entrants except on the terms they set.

Adequate supplies of potable water at minimum cost and the safe disposal of effluent are two of the major issues of our time however they are not currently being dealt with in an optimum manner in South Australia. I understand that a similar problem has been dealt with in NSW and a similar solution may be applicable to South Australia.

Another concern is the so called 'augmentation' fee being charged by SA Water on top of their existing fees and charges.

I will address the issue under the headings:

1. SA Water charter
2. Financial Practices
3. SA Water business practices
4. Possible solutions

1. SA Water charter

I contend that SA Water exists as a government monopoly being used to raise revenue for the state government and is not fulfilling its charter. This negatively impacts on private companies wishing to enter the water industry in South Australia. Companies looking to supply communities that SA Water does not service, or where the SA Water service is inadequate because of flow, quality and the cost of those services, are being excluded from entering the market. This monopoly impacts negatively on businesses, individuals and whole communities who receive overpriced and often inadequate water supply and sewerage services.

Refer to the SA Water Charter attachment 1.

2. Financial Practices

The net profit after income tax for the year ended 30th June 2005 was \$196 million with a dividend then paid to the State Government of \$155 million i.e. 78.8%. - according to the Auditor General's Report this will increase to 95% in 2005/6.

SA Water Financial Report P34 attachment 2

The SA Water Statement of Cash Flows (*attachment 3*) on page 68 of the Annual Report states that dividends of \$165.1 million, and tax equivalent payments of \$82.6 million, flow from SA Water to the State Government from receipts collected from customers of \$632.2 million.

This equates to 39.1%, which means that for each \$1 of SA Water revenue taken from the State's population, the government is taking 39c into general revenue. This only leaves 61% to operate their core business that is to supply water and sewerage services to the people of South Australia.

The 2005 Auditor General's report under 'New Financial Ownership Framework' states that there will be a 'dividend payout ratio of 95% based on the after tax profit' of SA Water (currently 78.8% or \$155m). Also of concern is the mention of 'a revised Community Service Obligation Agreement' (CSO), which I suspect means even less services will be provided by SA Water for regions outside of Adelaide.

This creates a 'round robin' situation. While the CSO is paid to SA Water apparently out of dividends paid to the Government from SA Water, this is later clawed back to the extent of the tax and dividend and returns to the Government. This will be exacerbated if dividends are increased to 95% of profits.

SA Water operations and costs are not transparent and they will not disclose the cost of supply of water to Eyre Peninsula, on the grounds of 'Commercial in Confidence'. Therefore scrutiny and assessment is prevented and the potential for competitive delivery of cheaper water by private enterprise. This also prevents any assessment of the application of the CSO to this area. There is a belief that Eyre Peninsula is subsidising the rest of the State but this cannot be tested.

If SA Water has best business practice principles, I also query their apparent high staff levels. Why does SA Water have around 1300 employees when much of the work you would expect them to be doing is actually being contracted out? Pages 63 and 64 (*attachment 4*) of the Annual Report lists these contracts with the most best known being the 'Adelaide Contract' with United Water International, 'to manage the operations and maintenance of metropolitan Adelaide water and waste water systems (including the delivery of capital works for rehabilitation and augmentation) for a period of 15.5 years from January 1996, and to develop a world class water industry.'

Another notable one is the ‘Provision of treated water to the Adelaide Hills, Barossa Valley, Mid-North and River Murray towns’, with Riverland Water Pty Ltd.

On page 66 (*attachment 5*), ‘Statement of Financial Performance’, ‘salaries and employee benefits expense’, is an amount of \$73.4 million for this financial year which is up from \$66.4 million for last financial year. While most of SA Waters responsibilities would be carried out in the regional areas I suspect that less than half of the estimated 1300 employees would be located there. There are very few employees on Eyre Peninsula even though at 2,400 kilometres it is one of the longest separate pipeline reticulation mains in the State.

Refer to SA Water 2004-05 annual financial report pages 1 to 65 available on the internet www.sawater.com.au/publications/annual_reports_for_the_full_report.

SA Water has decreased its expenditure on infrastructure from \$174m to \$105m over the last two years just when the claimed need for more water has increased and ‘water saving legislation is in place with penalties.

It is SA Government policy to reduce water consumption in South Australia by 20% and this is reflected in expenditure. This would not be the policy of a commercial operation which would seek to satisfy demand and increase production of water.

3. SA Water business practices

SA Water practice, despite its *Charter 5.1* “all operations of the Corporation are commercial operations...” fails as a commercial business.

The State government in May 2005 announced an extension of the Morgan-Whyalla River Murray pipeline from Iron Knob to Kimba, a distance of 90 kilometres at a cost of \$48.5 million. This was not all “new money”; \$25 million of that amount was from a failed commitment to put a desalination plant at the Tod Reservoir.

The extended pipeline:

- The initial 1.4 gegalitres, and even the proposed increase to 2.3 gegalitres at some future time, will not bring sufficient additional water to remove existing restrictions on Eyre Peninsula. Since the advent of the Eyre Peninsula Catchment Water Management Board, SA Water was given an overdraw allowance of 5% from the Uley basins on Eyre Peninsula in 2004-05 and has requested more water in 2005-06. SA Water has undertaken to “repay” this water at some time in the future;
- the pipeline water comes from the River Murray which, according to extensive and repeated publicity, is already over utilised,
- water distribution will have to be reversed at an additional cost (currently runs south from Port Lincoln north to Kimba)
- The alternative of a privately financed and operated desalination plant at Ceduna using the existing reticulation system, which could supply ample water to western Eyre Peninsula was not canvassed as a **permanent** solution. *See attachment 6*
The government did announce a “possible” desalination plant that “might” be built near Whyalla for BHP Billiton at some time in the future.

- In my opinion the cost of a supply from the Murray pumped to Whyalla and the new pipeline, would be considerably greater when all costs of operating and financing are taken into account, than a commercial desalination plant at Ceduna. If the desalination plant was in Ceduna instead of the possible BHP Billiton facility in Whyalla a better result would be achieved without the pipeline being necessary. Is this a government dictated policy based on an agenda outside the SA Water charter? Once built the fixed costs are effectively permanent as the scrap value would be minimal.
- The estimated water losses through leakage are very high. On Eyre Peninsula these exceed the water to be supplied by the pipeline. Being an effective monopoly with free water and pricing based on cost, this provides little incentive to fix the problem.

Refer to my 'Submission to the Public Works Standing Committee Hearing 29th June 2005' (attachment 7) and pages 6, 7, 34 and 35 of the House of Assembly Public Works Committee Transcript of proceedings on Eyre Peninsula Water Supply Upgrade dated 29 June 2005. (Attachment 8).

Refer also to Minority Report on the EP Water Supply Upgrade attachment 9

Note: Full Hansard reports available which include the unsatisfactory response from SA Water to my submission (www.parliament.sa.gov.au/committees/standing_committees/public_works_committee/reports/water/Report_217/Report).

Being a monopoly, SA Water decides its own manner of operation including selective charges. Augmentation fees are charged for developments in 23 towns in South Australia but these fees are not charged in metropolitan Adelaide and some larger towns. For Coffin Bay, the augmentation fee is \$5,500 per block. The justification given for the charge is that it contributes towards the infrastructure cost should Coffin Bay need to be connected to the main southern basins system or a small desalination plant. This is despite SA Water not having checked the capacity of the Coffin Bay lens supplying the town. Local people believe the lens is more than adequate to supply all their future needs and possibly more. The expansion of Coffin Bay township is limited because it is surrounded by national parks. Augmentation fees are part of SA Water's profit and part of the dividend to the state government. As in the case of the CSO, the receipt of this fee becomes part of the profit of SA Water, is theoretically taxed and then could have 95% of the balance paid to the Government. It is effectively a hidden tax on some, relatively vulnerable section of the community. The augmentation fee is an anti-competitive charge.

Refer to Attachment 10.

The Government is going to require water tanks on every new house. This is a high cost and ineffective solution to future water shortages in a Mediterranean climate where it rains when your tank is full and dry when empty. The water could be readily supplied by desalination at a considerably lower cost. (Waterproofing Adelaide tank water costs \$5.40 kl versus indicative pricing on desalination at <\$2.00kl). The combination of SA Water not investing in new and unlimited water resources using wind power or allowing private enterprise to supply combined with Government policy is distorting the market and preventing the introduction of lower cost solutions. The tanks are effectively a tax on new home owners with SA Water policy being closely aligned to the government policy.

SA Water takes water from underground resources without charge or 'consideration', while other potential commercial businesses are denied access to the same resources, even if they were prepared to pay an access fee. *SA Water monopoly page 30 from Public Works Committee Transcript of proceedings EP Water Supply Upgrade referred to above. Attachment 11.*

SA Water is effectively acting as a government monopoly supported by the state government as a community service yet selects where it will operate, the terms and conditions of operation. This is illustrated by the water supply west of Ceduna provided by the community and Ceduna Council with some grant funding for the original infrastructure but there are no concessions for the purchase of bulk water. There is also the situation at Port Kenny and Venus Bay where the community and the Elliston Council are expected to pay for new water supplies *Refer to pages 21, 22, 23 of the EP Water Supply Upgrade Transcript of proceedings Attachment 12* .

SA Water treats customers differently which, because of its monopoly position, it gets away with. Ceduna in particular has had to put up with burst water pipes and poor quality water which would not be allowed to persist in metropolitan Adelaide. *Refer to Attachments 13 and 14* .

The new marina development at Ceduna has I believe attracted around \$2 million in SA Water augmentation fees despite no houses yet built and no additional water being supplied to the area with existing water supply being of very poor quality.

The state government has accepted financial windfalls from sewer charges due to rising property values and the amalgamation of property values without any recompense to customers or changes to pricing. I agree with Mr Baddams who stated in his letter ‘My properties are assessed on total value – including adjoining land. This makes no logical sense at all. How does the extent and value of my land have any effect on the sewerage system connected to my house?’ *Refer to Wayne Baddams’ letter 4/12/05 and no reply as yet from Minister. Attachment 15*

At present SA Water, despite its charter, does not attempt to supply all South Australians with water or sewerage systems. The effluent systems (STEDS) are another impost that falls on the Councils and ordinary people. The Elliston Council for example, which covers 6,693 square kilometers, (one of the biggest in Australia) only had 807 full paying rate payers. It is impossible for them to fill the role of SA Water and the government, to provide both new water and STEDS systems to its small communities. This is stunting the growth of the region. SA Water is both a monopoly and a government instrumentality, yet supposedly operates on a commercial basis, raising considerable revenue annually for the government. This is unfair to say the least.

SA Water charges water rates on commercial buildings based on valuation. Many high value buildings would use little more water than a household with a garden but pay many thousands of dollars in water rates. This is a tax on business or a subsidy on households, or both, and is only possible due to its monopoly position.

4. Possible solutions

The water industry in South Australia could be subjected to changes similar to those proposed for adoption by the NSW water industry, opening up the industry to competition and improved service to consumers.

I have just read the IPART (Independent Pricing and Regulatory Tribunal of NSW) “*Investigation into Water and Wastewater Service Provision in the Greater Sydney Region*” recommendations to the NSW government. These recommendations propose similar solutions to the changes that I would envisage for SA Water. I will therefore send a copy of my letter to ESCOSA (Essential Services Commission of South Australia) the equivalent to NSW’s IPART, for their interest and to the ACCC for their attention.

All CSO work currently undertaken by SA Water should be available to private enterprise through open tender.

The building of (STEDS) effluent disposal systems currently required by communities are said to be 30 years behind schedule and of those already operating many are in need of maintenance. Community health, tourism industries and also the new aquaculture industries around our coast make clean water a priority if the state is to maintain our clean green image. STEDS schemes would be in my view, a legitimate use of government CSO funding but should be tendered out in the interests of our communities and our environment.

I have included as *attachments 16 and 17* two of my recent submissions. One is to the Essential Services Commission of South Australia for the 'Inquiry into the 2006-07 Water and Wastewater Pricing Processes' dated 28th September 2005 and the other is to the South Australian Parliament's Statutory Authorities Review Committee, 'Inquiry into the South Australian Water Corporation' dated 27th October 2005.

I seek your support in removing what I consider is the Government of South Australia's abuse of SA Water's monopoly position so that private companies can more easily enter the water supply and sewerage industries in South Australia.

There must be protection for CSO Funding to provide services in regional areas that most city people take for granted but open up CSO's for private tenders. The regions, who helped pay for city services and infrastructure in the past through income from the sheep, wool, grain, timber, mining and fishing industries, is now subject to a user pays system that does not help to provide the necessary infrastructure and services that they require. Rural communities pay SA Water for poor service and high prices because funding is pillaged from the 'business' by the Government.

Local SA Water employees live in our communities and do the best they can to maintain our services under the constraints of the government and the bureaucracy and I have no complaint with them. However competition is the only way I can envisage that regional South Australians will be able to enjoy better quality and more water and improved sewerage systems into the future.

If the supply of water in South Australia was opened up to competition with contract suppliers but probably SA Water being the distributor, potential water shortages and *water saving legislation* could be virtually eliminated. It would need appropriate controls due to SA Water having access to the cheapest water however systems would be well established elsewhere.

Your help to rectify this situation is requested. I would be pleased to discuss these issues with you or clarify any points.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Liz Penfold', written in a cursive style.

Mrs. Liz Penfold MP