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Urban Water Inquiry
Productivity Commission
Locked Bag 2, Collins Street East
Melbourne VIC 3165

Dear Commissioners

Inquiry into Australia's Urban Water Sector

The National Competition Council ('Council') welcomes the opportunity to make a submission to the Productivity Commission's Inquiry into Australia's Urban Water Sector. This submission discusses the potential for appropriate regulation of third party access to water infrastructure to enhance competition and contestability in the urban water sector.

This submission first outlines the Council's roles and responsibilities and the operation of the National Access Regime in Part IIIA of the *Trade Practices Act 1974* ('TPA'). It then considers the potential application of the National Access Regime to urban water infrastructure services and examines the cases where it has been invoked in the past.

The National Access Regime provides a legal avenue through which an access seeker can gain access to the services provided by an infrastructure facility on commercial terms and conditions. In broad terms, the regime provides a means of promoting competition in markets where the ability to compete effectively depends on being able to use a monopoly infrastructure service. At the same time, the regime ensures that infrastructure owners receive a commercial return and that incentives for efficient investment are not affected.

It is the Council's conclusion that the regulation of access under the National Access Regime may be appropriate in some situations in the water sector, but a coordinated national approach to access regulation, similar to the approach adopted for the gas industry, is likely to have significant merit for urban water infrastructure services.

The Council's roles and responsibilities

The Council is responsible for considering applications by access seekers for the declaration of services under the National Access Regime established by Part IIIA of the TPA. The Council makes recommendations on these applications to decision making ministers after conducting a transparent public consultation process.

The Council is also responsible for considering applications from state and territory governments to have their access regimes certified as effective under Part IIIA of the TPA. Where the Council

receives an application for certification it must recommend to the Commonwealth Minister whether or not a regime should be certified as effective. Where a state or territory regime is certified, that regime will apply to the exclusion of other forms of access regulation. The certification process is designed to ensure state and territory access regimes embody the same principles that underpin the national approach and to allow state and territory regimes to take precedence where they are found to be effective. The principles that must be considered in assessing whether an access regime is effective include the scope of the access regime, the treatment of interstate issues, the negotiation framework for determining the terms and conditions of access, dispute resolution mechanisms, and the promotion of efficiency.[1]

In addition to these roles, the Council previously had responsibility for overseeing and assessing the progress of Australian governments in implementing the National Competition Policy ('NCP') and related reforms. The NCP was Australia's landmark microeconomic reform program based on the principle that competitive markets will generally best serve the interests of consumers and the wider community.

When the NCP program concluded in 2005-06, the Council of Australian Governments ('COAG') endorsed the need to maintain reform momentum and agreed to the COAG Reform Agenda to continue competition and regulatory reform.[2] It was decided that the Council would continue responsibility for third party access regulation and that the COAG Reform Council would supervise the implementation of the COAG Reform Agenda.

The National Access Regime – Part IIIA of the TPA

The National Access Regime is established by Part IIIA of the TPA, with the purpose of providing a mechanism for resolving disputes over access to infrastructure services where it is in Australia's national interest that such disputes be resolved. Regulation under the National Access Regime involves two stages.

The first is the declaration stage, in which the Council considers applications for declaration of services against the declaration criteria and other prescribed factors in Part IIIA of the TPA. The declaration criteria are set out in section 44G(2) of the TPA as follows:[3]

(a) that access (or increased access) to the service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service;

(b) that it would be uneconomical for anyone to develop another facility to provide the service;

(c) that the facility is of national significance, having regard to:

  (i) the size of the facility; or

  (ii) the importance of the facility to constitutional trade or commerce; or

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1 See clauses 6(2)-(5) of the Competition Principles Agreement.

2 Following the NCP, COAG adopted the National Reform Agenda in February 2006, and subsequently the COAG Reform Agenda in March 2008.

3 Criterion (d), that access to the service can be provided without undue risk to human health or safety, was removed by the *Trade Practices Amendment (Infrastructure Access) Act 2010* (Cth) which took effect on 14 July 2010.

(iii) the importance of the facility to the national economy;

(e) that access to the service is not already the subject of an access regime that has been certified as effective under section 44N of the TPA (unless the Council considers that there have been substantial modifications of that regime since it was certified under section 44N); and

(f) that access (or increased access) to the service would not be contrary to the public interest.

The Council then makes a recommendation to the designated Minister who decides the application after considering a parallel set of criteria. The Council cannot recommend that a service be declared unless it is satisfied that all of the declaration criteria are met. Similarly, the designated Minister must also be satisfied that all the criteria are met before declaring a service. If a service is declared, it is brought within Part IIIA's negotiate-arbitrate arrangements.

The criteria for declaration are an essential element of Part IIIA and ensure access regulation is applied in situations where it is likely to enhance competition and economic efficiency. In particular criterion (b) seeks to confine regulatory intervention to services provided by facilities that exhibit natural monopoly characteristics such that the construction of multiple such facilities would be likely to waste national resources. It is not designed to capture services provided by facilities merely because they are costly. Criterion (a) is also designed to limit the scope of regulation. It requires that access promote competition in a dependent market – this criterion is concerned with the state of competition not the ability of particular parties to participate in a market.

The Council has published a guide to declaration which provides a more detailed explanation of the requirements for declaration under Part IIIA of the TPA.[4] This guide is available on the Council's website (the Council is currently updating the guide to incorporate the amendments implemented by the *Trade Practices Amendment (Infrastructure Access) Act 2010* (Cth) and recent decisions of the Australian Competition Tribunal). In the Council's view it is critically important that regulation of access is predicated on the declaration criteria being met. If not, there is no basis for confidence that such regulation is likely to enhance competition or efficiency.

The second stage is the negotiation and arbitration process which requires the service provider to enter into access negotiations with access seekers. This process is a light handed intervention designed to maximise opportunities for the commercial resolution of access issues, minimise regulatory intervention and protect the legitimate interests of service providers so as to ensure that incentives for efficient investment and operation are maintained. These arrangements are not limited to the party who applied for declaration and other access seekers can seek to use the declared service. Where the parties are unable to reach an agreement the Australian Competition and Consumer Commission ('ACCC') is available to arbitrate access disputes at the request of any party seeking to use a declared service (not just the party which sought the declaration).

In the Council's view the National Access Regime generally provides an appropriate approach to determining where regulation to facilitate third party access to infrastructure is likely to be in the national interest and a flexible approach to resolving access disputes.

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4 National Competition Council 2009, *Declaration of Services under Part IIIA of the Trade Practices Act: a guide*, Melbourne. Available at http://www.ncc.gov.au/images/uploads/Declaration_Guide.pdf

Application of National Access Regime to urban water infrastructure services

The Council considers that the National Access Regime has the potential to address some of the access issues that may arise in relation to urban water infrastructure services and that the declaration criteria are likely to appropriately focus the scope for regulation.

In the Council's view the declaration criterion in section 44G(2)(c) of the TPA which requires that the facility that provides the service be of national significance may be an obstacle to declaration in some situations. This criterion requires that to be declared a service must be provided by a facility that is nationally significant having regard to the size of the facility, the importance of the facility to constitutional trade or commerce, or the importance of the facility to the national economy. While the Council considers that the threshold for a facility to be of national significance will allow for declaration of urban water infrastructure service(s) in larger metropolitan centres, subject to the other declaration criteria being met, it may preclude, or at least give rise to significant doubt as to, the application of the National Access Regime in smaller centres or to parts of larger facilities.

In this regard, the Council refers to the *Report on Third Party Access in the Water Industry* prepared for the Council by Tasman Asia Pacific in 1997 (copy attached) which concluded that there are many services provided by the water industry which are likely to meet the criteria for declaration. However, that report also observed that:

> "The national significance test is, arguably, the most difficult hurdle for any declaration application to overcome. Water facilities can be judged as nationally significant in their own right, though this may be difficult, or because they support an industry which produces a highly traded good or service."

Whether the national significance criterion is met will depend on the circumstances of a particular case, and it is less certain whether water infrastructure in regional centres would be considered nationally significant.

The National Access Regime has been invoked on two occasions to regulate third party access to water infrastructure services. In 2004 the Council received two applications for the declaration of water infrastructure services in NSW, one of which was ultimately declared.

In 2008 the Council also considered whether to recommend certification of the NSW Government's state-based third party access regime for water industry infrastructure services established by the *Water Industry Competition Act 2006* (NSW) ('the Act') and the *Water Industry Competition (Access to Infrastructure Services) Regulation 2007* (NSW) ('WICA Access Regime'). These applications and the WICA Access Regime are discussed in the following sections.

Re Services Sydney Pty Ltd [2005] ACompT7

In March 2004 the Council received an application under Part IIIA of the TPA from Services Sydney Pty Ltd for a recommendation to declare certain services provided by Sydney Water's sewerage reticulation network in the Sydney metropolitan area. Services Sydney intended to compete with Sydney Water as a provider of sewage collection services. Instead of building its own sewerage network, Services Sydney sought access to Sydney Water's network to transport the sewage of its potential customers to connections with its own pipeline, which would then transport the sewage

to Services Sydney's treatment plant. Services Sydney intended to treat the sewage and supply the recycled water for non-potable purposes, a process known in the industry as 'sewer mining'.

On 1 December 2004 the Council provided its recommendation to the decision-making Minister, the Premier of NSW, that the six sewage interconnection and transportation services provided by Sydney Water as part of Sydney Water's Bondi, Malabar and North Head reticulation networks be declared for a period of 50 years.

The Council found that access to the services provided by these networks was necessary for the development of competition in the provision of waste water services in the relevant areas and would materially increase competition in the sewage collection market and the recycled water market. The Council also found that the sewerage networks were uneconomical to duplicate because the cost of developing new facilities to provide the services was estimated to be in the vicinity of $7 billion and the capacity of the existing facilities was sufficient to meet reasonably foreseeable demand for the services for the next fifteen years. In addition, the Council found that each of the facilities was of national significance having regard to their physical size, the essential services they provided to a significant population base, and their contribution to Sydney's economic activity. The Council further considered that access could be provided in a manner which was consistent with health and safety requirements and was not contrary to the public interest.

The NSW Premier did not publish a decision within 60 days of receiving the Council's recommendation and was deemed to have decided not to declare the services, pursuant to section 44H(9) of the TPA. Services Sydney sought review of the Premier's deemed decision by the Australian Competition Tribunal ('Tribunal'). The criteria in dispute between the parties were limited to criterion (a) and criterion (f) in section 44H(4) of the TPA, namely whether competition would be promoted in another market and whether declaration would be contrary to the public interest. The parties agreed that the declaration criteria (b) to (e) in section 44H(4) of the TPA were met.

Sydney Water's arguments in relation to criterion (a) focused on whether competition would be promoted in the dependent markets for sewage collection, sewage treatment and recycled water. In relation to criterion (f), Sydney Water argued that the provision of access would require various other regulatory reforms and that a state-based access regime, which would deal with these issues in an integrated package, would be preferable to declaration under Part IIIA of the TPA. In support of Sydney Water's argument, the Premier of NSW made a statement to the Tribunal confirming the NSW Government's intention to develop an effective access regime for water industry services. For this reason, Sydney Water argued that declaration would be against the public interest.

On 21 December 2005 the Tribunal handed down its decision to set aside the deemed decision of the Premier and to declare the services for a period of 50 years from 21 December 2005 (*Re Services Sydney Pty* [2005] ACompT 7, hereafter referred to as *'Re Services Sydney'*). The Tribunal was satisfied that criteria (b) to (e) in section 44H(4) of the TPA (which were not in dispute between the parties) were met – namely, that it would be uneconomical to duplicate the facilities to provide the services because Sydney Water's sewerage reticulation networks were natural monopolies; that each of the three facilities were of national significance having regard to their size and the pervasive use of sewage services by households, business and industry; that access to the services could be provided without undue risk to human health and safety; and that access to the services was not already the subject of an effective access regime.

In relation to the criteria that were in dispute, the Tribunal was satisfied that criterion (a) was met on the basis that declaration would promote competition in the markets for sewage collection and recycled water. The Tribunal did not determine decisively whether competition would be promoted in the market for sewage treatment services. The Tribunal rejected Sydney Water's argument in relation to criterion (f) and held that there was no gap in the regulatory system which would create a danger to public health or the environment and thereby make new entry contrary to the public interest.[5] The Tribunal further held that there was nothing to guarantee that the NSW Government would introduce an effective access regime in the future, or to indicate when such a regime might be introduced. However, if an effective access regime were to be established by the NSW Government, the Tribunal noted that steps would be taken to revoke the declaration.[6]

Lakes R Us Pty Ltd

In October 2004 Lakes R Us Pty Ltd applied to the Council under Part IIIA of the TPA for a recommendation to declare the water storage and transport services provided by Snowy Hydro Ltd and the State Water Corporation. Lakes R Us intended to store water sourced from unused allocated water entitlement holders downstream and then release the stored water on demand to users in the Murray and Murrumbidgee irrigation areas.

In January 2006 the acting Premier of NSW, acting on the Council's recommendation, decided that the services should not be declared on the basis that he was not satisfied that declaration would promote competition in a dependent market (criterion (a) in section 44G(2) of the TPA) and was not satisfied that declaration would not be contrary to the public interest (criterion (f) in section 44G(2) of the TPA). Lakes R Us applied to the Tribunal for a review of the Premier's decision, but subsequently withdrew its application.

This application did not relate to urban water infrastructure. However the Council's recommendation did note the critical relationship between regulation of third party access and the broader regulatory environment within which water infrastructure operates.

New South Wales WICA Access Regime

The declaration made by the Tribunal in *Re Services Sydney* prompted the NSW Government to develop the WICA Access Regime in 2006. In late 2008 the NSW Government applied to the Council for a recommendation that the WICA Access Regime be certified as an effective regime under section 44M of the TPA. The WICA Access Regime applies in respect of the areas listed in Schedule 1 of the Act which presently comprise the areas of operation of Sydney Water and Hunter Water. Under the regime, the Premier may expand the areas in Schedule 1 by order published in the Gazette. The Act does not specify any process for assessing additions to Schedule 1.

At present the only water infrastructure services that are the subject of a coverage declaration under the WICA Access Regime are the sewerage services provided through Sydney Water's Bondi, Malabar and North Head reticulation networks. These services were deemed to be the subject of coverage declarations upon the commencement of the Act. The period of coverage is from 1 January 2007 to 31 December 2056, subject to any revocation declaration. These services are the same services that were declared by the Tribunal in *Re Services Sydney*.

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5 *Re Services Sydney Pty Ltd* [2005] ACompT 7 at [198].

6 *Re Services Sydney Pty Ltd* [2005] ACompT 7 at [213]-[214].

On 13 August 2009 the Minister for Competition Policy and Consumer Affairs accepted the Council's recommendation that the WICA Access Regime be certified as effective for a period of 10 years. Consequently, the services that were declared in *Re Services Sydney* and regulated under the National Access Regime became subject to an 'effective access regime', with the effect that the criterion for declaration in subsection 44H(4)(e) of the TPA was no longer met. Accordingly, on 8 September 2009 the Council made a recommendation to the Premier of NSW that the declaration in *Re Services Sydney* be revoked. The Premier, acting on the Council's recommendation, revoked the declaration on 1 October 2009.

In its draft and final recommendations on the WICA Access Regime, the Council noted that the WICA Access Regime essentially mimics the National Access Regime, substituting the Independent Pricing and Regulatory Tribunal of NSW (IPART) for the ACCC as the arbiter of access disputes and an IPART report and a decision by the NSW Premier for the process of declaring a service under Part IIIA of the TPA. The Council was of the view that a state or territory access regime that merely replicates the declaration and negotiate/arbitrate approach already available under the general provisions of the National Access Regime appeared to offer little benefit while arguably adding to cost and uncertainty. The Council considered that the WICA Access Regime did not appear to add refinement or certainty to what was already provided for under the National Access Regime.

Whilst the Council considered that the WICA Access Regime met the requirements for certification, in its final recommendation it suggested that a better approach to regulating access would be to provide greater certainty by delineating the scope of a regime's application at the outset. In the Council's view, a process for declaring particular water infrastructure services on a case by case basis is unnecessary. The Council observed the contrast between the process for adding geographic areas in the WICA Access Regime and the arrangements for the regulation of third party access to natural gas pipeline systems. Under the National Gas Law, all pipelines were either covered upon the commencement of the law, or are within the scope of the gas access regime in the statute. In this sense the scope of the regime regulating access to gas pipelines cannot be expanded independently of coverage questions being explicitly addressed.

Although not a requirement for certification, the Council considered it desirable that an access regime also incorporates arrangements for limited merits review of critical decisions, particularly where a government has a significant ownership interest in the businesses that are potentially exposed to competition from access seekers. In this regard, the Council noted that Part IIIA of the TPA provides for merits review in relation to the equivalent processes under the National Access Regime, and that the national gas and electricity regulatory regimes provide for limited merits review of key regulatory decisions.

A coordinated approach to access regulation of urban water infrastructure services

The Council is of the view that the pure negotiate/arbitrate model for the resolution of access disputes under the National Access Regime may not provide a sufficient level of certainty as to the terms and conditions of access to urban water infrastructure services, and that an enhanced regulatory approach may be desirable.

Access to water infrastructure services is an area where coordinated consideration across jurisdictions would be valuable and where a regulatory approach tailored to the likely nature of access issues in the water sector is highly desirable. Instead of potentially fragmented jurisdictional regulation, a coordinated national approach is likely to reduce uncertainty and costs for access

seekers and existing water infrastructure owners and encourage efficient use of and investment in water infrastructure.

Governments have, for example, adopted jurisdictional regimes for access regulation of gas pipelines—which rationalise the process of determining what pipelines are regulated, allow for light handed and fuller forms of regulation and use of a national regulatory body—and for regulation of the electricity sector—which apply the relevant regulation to virtually all transmission and distribution infrastructure without requiring case by case declaration or coverage decisions. The Council considers that this approach could be used a model for the development of jurisdictional regimes for access regulation of urban water infrastructure.

The Council is conscious that third party access to water infrastructure services is a relatively new issue and that the level and nature of any access that may be sought is at present uncertain. Whilst the Council considers that the general provisions of the National Access Regime may address at a basic level some of the access issues that may arise in the short term—with asset owners submitting undertakings to the ACCC or access seekers making declaration applications—in the medium term a cooperative approach (along the lines of that adopted for access to energy infrastructure) has significant merit. This approach also has the advantage of establishing a national basis for access regulation while retaining direct state and territory authority.

In particular, the Council considers that if an appropriate access regime is established to regulate access to natural monopoly infrastructure used to provide 'water transport and distribution' and 'wastewater transport' services in the supply chain (referred to in 'Figure 2: water and wastewater supply chain' on page 10 of the Productivity Commission's *Issues Paper for Australia's Urban Water Sector*, September 2010) less regulation will be required for the other four stages in the supply chain.

Yours sincerely

John Feil
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Attachments: Tasman Asia Pacific 1997, *Report on Third Party Access in the Water Industry*