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Dear Sir/Madam

SUBMISSIONS ON THE WATER INDUSTRY (THIRD PARTY ACCESS) AMENDMENT BILL 2013

Thank you for the opportunity to provide submissions on the consultation draft of the Water Industry (Third Party Access) Amendment Bill 2013 (**Bill**).

As the Commission noted in its submissions on the earlier Access Report in March 2013, a robust and comprehensive access regime is necessary to achieve the objects of the Water Industry Act 2012. The promotion of efficiency, competition and innovation in the water industry (Water Industry Act, section 3(b)) is critical in protecting South Australian consumers' long-term interests.

It is the Commission's position that a robust and comprehensive third party access regime and the consequential introduction of competition within contestable segments of the water supply chain would deliver benefits for South Australian consumers and assist in addressing cost of living and affordability issues.

However, as noted in the Commission's March submissions, the nature, strength and scope of the proposed regime is so limited as to materially impede the delivery of those benefits to South Australians. Therefore, the Commission again recommends that the nature, strength and scope of the regime be revisited.

The Commission notes that the positions put in the Bill are essentially consistent with the positions proposed in the earlier Access Report. In light of that, in responding to the Bill the Commission adopts in full its March 2013 submissions and attaches those herewith so that they can be considered further in the development of the final Bill. In addition, the Commission makes further submissions (as set out below) based on its consideration of the Bill and the accompanying Explanatory Memorandum.

Overarching design considerations – nature, strength and scope

The Commission notes that an underpinning assumption (set out in the Explanatory Memorandum), which appears to have driven the nature, strength and scope of the Bill, is that as SA Water will remain a vertically-integrated, Government-owned utility and that there will not be full retail contestability, the access regime should be light-handed and not have any regulator-determined elements (whether as to terms and conditions or as to prices).

In contrast, the Commission considers that SA Water's vertical integration and the potential contestability of at least significant (by volume) segments of the retail market both mean that a stronger access regime is required.

Nature

The Explanatory Memorandum draws on the Productivity Commission's *National Access Regime Draft Report*, in support of its assumption on the need for a more light-handed regime.

In doing so it notes that the rail and ports access regimes in South Australia have a more light-handed flavour and proceeds on the basis that the ports and rail statutory regimes are the best templates on which to model the third party access regime for the water industry.

As noted in the Commission's original submission (at paragraphs 3.13 to 3.17), there are major differences between the ports, rail and water industries and there are good reasons to consider other models in developing the water third party access regime. In particular, the Commission would emphasise that the rail and ports industries differ from the water industry in the nature of ownership (public versus private) and the extent of vertical integration; in addition, those industries are characterised by the opportunity for strong inter-modal competition – a possibility not present in the water supply industry.

Furthermore, in relying on the Productivity Commission's report, the Explanatory Memorandum has not recognised the full scope of the recommendations therein.

In that report, the Productivity Commission stated that access frameworks should give:

> *... primacy to private negotiation between a service provider and an access seeker,* ***subject to the threat of arbitration by the ACCC****.*

That statement explicitly contemplated that the ACCC would have the power make binding determinations as to price; in that context the Productivity Commission went on to note that:

> *In November 2006, Services Sydney formally notified the ACCC of an access dispute, having been unable to negotiate access to declared sewage transportation and interconnection services operated by Sydney Water.* ***The ACCC's final determination set pricing terms*** *using a retail price minus avoidable costs methodology (ACCC 2007).*
>
> (Productivity Commission, *National Access Regime Draft Report*, May 2013, page 70; emphasis added)

The Commission would therefore recommend that further consideration be given to the nature of the proposed regime, to provide the ability for alternative regulatory approaches to be adopted by the regulator where the benefits exceed the costs.

Strength

The Explanatory Memorandum also assumes that more heavy-handed regimes (such as suggested, at least in part, in the Commission's original submission) are only appropriate for adoption in industries which are vertically integrated and subject to substantial economic reform.

As noted in the Commission's original submission (at paragraphs 3.5 and 3.6) and is argued further below, the lack of vertical separation and competition at present implies that a stronger – rather than a weaker – third party access regime is required.

Evidence from the United Kingdom supports the Commission's position. In the United Kingdom the water industry is characterized by vertical integration and considerable retail contestability.

As the water industry regulator, OFWAT, observed recently in the context of the United Kingdom Government's draft Water Bill 2013 (July 2013):

> *The water sector in England and Wales is dominated by **vertically integrated** companies. **This may give those companies the incentive (and the ability) to discriminate against new entrants in favour of their own operations.***
>
> ***This is a fundamental concern that we will need to address through access pricing** and by using other tools such as market codes.*
>
> ***
>
> *The Water Bill **does not** propose for the monopoly companies in England and Wales to be legally separated, **which places an even greater importance on developing an effective access pricing framework.***
>
> (OFWAT, *Future access pricing in the water sector: A discussion paper,* November 2013; emphasis added)

OFWAT has also noted, in the Scottish context where there is full retail contestability in the non-residential water sector, that there is a risk that transparency may be reduced and transaction costs increased in a negotiate/arbitrate framework:

> *The Scottish non-domestic market is designed to be both as transparent as possible and to minimise transaction costs. **The market is therefore built on the basis of regulated rather than negotiated access.***
>
> (OFWAT, *Water and sewerage services in Scotland: An overview of the competitive market,* November 2013; emphasis added)

Having regard to the marked similarity between the situations in the United Kingdom and that existing in South Australia and the need to provide certainty, transparency and low transactions costs, the Commission would again recommend that the strength of the proposed regime should be revisited.

In doing so, the objects of the Act - **the promotion of efficiency, competition and innovation in the water industry** – should be the paramount considerations.

Scope

For reasons explained below, the question of scope is a significant issue in terms of the Bill.

The Explanatory Memorandum identifies certain classes of services which may (to a greater or lesser extent) be brought within the scope of the regime. It argues that these services fall within the scope of the general principles embodied within clauses 6(3)(a)(1) and (2) of the Competition Principles Agreement.

The Explanatory Memorandum goes on to note that other infrastructure *may* be included (e.g., the Willunga and Virginia pipelines), albeit that the nature of the regime may be even more light-handed for that other infrastructure.

However, the Bill does not set out any principles or statutory regime by which those services will be included within the regime, nor does it deal with the *degree* to which the regime will apply to different infrastructure services, other than to provide that the Governor may make proclamations as to those matters.

This provides no certainty to potential access seekers or the community at large.

Section 86B(2) of the Bill provides:

> *(2) The Governor may, by proclamation—*
>
> *(a) declare that operators of water infrastructure or sewerage infrastructure, or a specified class of such infrastructure, are subject to the operation of this Part; and*
>
> *(b) declare the extent to which this Part will apply in relation to—*
>
> *(i) specified water infrastructure or sewerage infrastructure, or a specified class of such infrastructure; and*
>
> *(ii) specified infrastructure services, or a specified class of such services; and*
>
> *(c) vary or revoke a declaration under this section.*

This is a critical threshold issue on which the success of the entire regime may depend - there is no clear, open or transparent basis on which infrastructure services will be included within the regime.

It is submitted that the Bill should at least adopt concepts such as those set out in clause clauses 6(3)(a)(1) and (2) of the Competition Principles Agreement as the principles by which infrastructure may be included within the regime.

Further, the Bill should provide a mechanism by which an interested party could seek for infrastructure services to be declared for the purposes of the regime.

For example, under the New South Wales' Water Industry and Competition Act 2006, an application for coverage of an infrastructure service may be made by:

- the service provider;
- an access seeker who has tried, but failed, to obtain access or change an aspect of that person's existing access; or
- the Minister.

The New South Wales Minister is responsible for making a coverage declaration and, in doing so, must consider a report prepared by the regulator (the Independent Pricing and Regulatory Tribunal) as to the extent to which the application would meet the relevant access principles (Water Industry and Competition Act 2006, Division 2).

Further, under the National Gas Law, an interested person may apply for "coverage" of a particular gas pipeline for the purposes of bringing that pipeline within the scope of the access regime provided for within that Law. In such cases, the relevant Minister (State or Commonwealth) makes a decision on the application based on the advice of the economic advisor (the National Competition Council) having regard to clear, open and transparent statutory criteria:

- that access (or increased access) to pipeline services provided by means of the pipeline would promote a material increase in competition in at least 1 market (whether or not in Australia), other than the market for the pipeline services provided by means of the pipeline;
- that it would be uneconomic for anyone to develop another pipeline to provide the pipeline services provided by means of the pipeline;
- that access (or increased access) to the pipeline services provided by means of the pipeline can be provided without undue risk to human health or safety;
- that access (or increased access) to the pipeline services provided by means of the pipeline would not be contrary to the public interest.

Without suggesting that those specific criteria or that specific regime should be adopted within the Bill, it is suggested that there is a need for a clear, open and transparent process through which:

- infrastructure services are brought within the regime;
- differing levels of regulation are applied to those services; and
- any person may make an application for an infrastructure service to be brought within the regime.

In the absence of such mechanisms the Commission questions the potential for the proposed regime to meet the objects of the Water Industry Act.

In addition, as proposed in its earlier submissions, the Commission would again recommend that consideration be given to providing access to underlying resources as well as infrastructure services. The Commission provided reasons for that recommendation at 2.15 to 2.35 of its March submissions.

In the United Kingdom, retailers have been able to obtain access to water delivered to their customers' premises for a number of years. More recently, the United Kingdom's draft Water Bill 2013 has been released for consultation (July 2013). That Bill contains express provisions dealing with the issues raised by the Commission – provision of access to bulk supplies. For example, clause 8 of the Bill provides that:

> *(3) On the application of the qualifying person or the supplier, the Authority may—*
>
> *(a) if it appears to the Authority that it is necessary or expedient for the purposes of securing the efficient use of water resources, or the efficient supply of water, that the supplier should give a supply of water in bulk to the qualifying person, and*
>
> *(b) if the Authority is satisfied that the supplier and qualifying person cannot reach agreement within a reasonable time,*
>
> *by order require the supplier to give and the qualifying person to take a supply of water in bulk for such period and on such terms and conditions as may be specified in the order.*

This is a clear example of provision of access to resources and, in the South Australian context, such a provision in the proposed regime would enhance competition and innovation – the stated objects of the Water Industry Act. The Commission recommends that this issue should be revisited and equivalent provision ought to be made in the final Bill.

Dispute Resolution

The proposed regime continues to provide for a two-step dispute resolution framework: conciliation conducted by the Commission followed by binding arbitration by a Commission-appointed arbitrator.

The Commission would again submit that the potential for it to arbitrate disputes and make binding determinations as to prices and terms and conditions should not be excluded from the regime.

In its original submission (at paragraphs 3.19 to 3.22), the Commission argued against the proposition that the Minister is to be provided a right of participation in arbitration proceedings.

The justification given in the Explanatory Memorandum for the inclusion within the Bill of the Minister's right of participation is that, in the case of the intra-state rail access regime, the relevant Minister has such a right. That justification does not grapple with a fundamental difference between the circumstances of ownership of the relevant rail infrastructure and the ownership of SA Water's infrastructure.

The intra-state rail infrastructure that is subject to the access regime is in private ownership. Therefore, there may be justification for Ministerial involvement on policy grounds, given that he or she will have no relevant financial or other controlling interest in the subject matter of any dispute.

In contrast, SA Water's infrastructure is in public ownership, with the Minister holding shares in SA Water; there is, therefore, the potential for the Minister to have both direct and indirect conflicts of interest in respect of a dispute arising under the proposed regime. That potential for a conflict of interest is likely to have significant impacts on confidence in the regime.

Section 86ZD – Formal requirements related to awards

This proposed section currently provides that the parties, the Minister and designated Government Departments will receive a copy of a *draft* arbitration award and may make submissions on that *draft* but does not provide the same rights to the Commission (notwithstanding that, under section 86S, the Commission has a right to join as a party, call evidence and make representations).

At the same time, however, the section also provides that the Commission has a right to receive a copy of the *final* award.

To provide equal rights to all parties, the final Bill should provide that the Commission has the right to receive and comment on the *draft* award.

Section 86ZS - Review of Part (Access Regime)

This section provides that, every five years, the Commission must conduct a review into the on-going operation of the access regime.

The terms of the review as set out in section 86ZS are very specific:

> *The regulator must, within the last year of each prescribed period, conduct* ***a review of water infrastructure and sewerage infrastructure subject to this Part*** *to determine whether this Part should continue to apply.*
> (emphasis added)

It is submitted that the scope of the review is too narrow: reviewing only the infrastructure services *currently within* the regime tells only part of the story about the effectiveness of the regime.

Reviewing the supply chain more broadly, and hence the potential need for on-going access or for access to a broader range of infrastructure services than might currently be within scope, is arguably a superior test. It is therefore recommended that the terms of reference should not be restricted as at present and should instead provide that the Commission may also consider other matters which it considers relevant.

In conclusion, the Commission welcomes moves towards the development of a third party access regime but remains concerned that the nature, strength and scope of the proposed regime is so limited as materially impede the delivery of benefits to South Australians – in both the short and the long term. This may have continued impacts on affordability and cost of living issues and, as a result, the Commission recommends further consideration of the fundamental assumptions which appear to be driving the regime contained in the Bill.

The Commission would be delighted to discuss and explain these submissions with you at any time. Should you wish to discuss this matter or arrange a meeting, please contact me on telephone 8463 4444.

Yours sincerely

Paul Kerin
CHIEF EXECUTIVE OFFICER