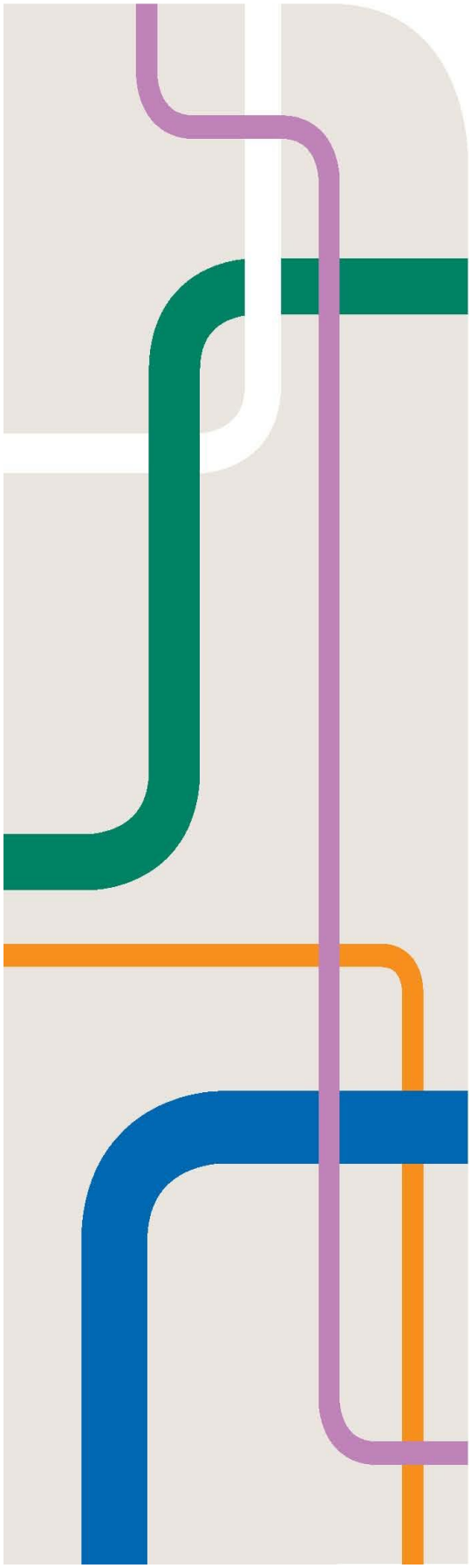
Government of South Australia

SA Water



SA Water Response

Access to Water and Sewerage Infrastructure

March 2013

Table of Contents

1 Introduction

SA Water Corporation (SA Water) supports the government's recommendation for the introduction of a state-based third party access regime for South Australia's water and wastewater industry, provided that no other customer should be worse off as a result of a third party gaining access, including public health safeguards. A successful regime would provide greater certainty and transparency for both access seekers as well as infrastructure operators, increasing scope for innovation in the industry. SA Water, established under the *South Australian Water Corporation Act 1994*, is committed to providing water and sewerage services for the benefit of the people and economy of the State.

SA Water provides in this submission a detailed response to the *Access to Water and Sewerage Infrastructure Report* (the Report) published by the Minister for Water and the River Murray (the Minister) on 1 February 2013[1].

Both international and Australian experiences show third party access is often very difficult to implement. Third party access regimes in water industries are often implemented in a staged manner due to the complexities and difficulties associated with successfully introducing a purist economic theory to an industry with a number of practical, social and pricing distortions.

This is further demonstrated in the international arena where it takes decades of insight to begin to solve some of the issues and complexities peculiar to the industry arrangements and operating environment. No proven methodologies exist on various aspects of implementation such as business and accounting separation, pricing and regulatory scope. Although there are examples of well established access regimes in other industries in Australia, such as gas, electricity, rail, ports and telecommunications, each industry is unique. Delivery of water and wastewater services presents some challenging social equity considerations including affordability, health and safety as well as environmental issues. While we can draw from lessons learned from other industries' access regimes, careful consideration and incremental application is necessary to ensure that unintended outcomes are minimised.

In the Report, the Government seeks consultation with regards to the establishment of an access regime for the South Australian water industry and is specifically seeking consultation on the possibility of a legislated state-based access regime for water and sewerage infrastructure. The key features of the proposed state-based access regime include:

- coverage of bulk water transport, water distribution transport, local sewage transport and bulk sewage transport services;
- appointment of the Essential Services Commission of South Australia (ESCOSA) to provide oversight to the regime, with responsibility for monitoring the regime and ensuring that commercial negotiation and arbitration occurs in a manner consistent with prescribed principles;
- periodic review of the scheme every 5 years;
- a legislated dispute resolution process to satisfy the certification requirement for enforceable access regimes; and
- potential scope for the regulator to determine access pricing principles in accordance with requirements set out in national competition principles[2].

The object of the *Competition and Consumer Act 2010* (CCA) is "*to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection*". The public interest in competition lies in the welfare enhancement that may be achieved through competition, rather than competition as its own end.

[1] Department of Treasury and Finance, Access to Water and Sewerage Infrastructure, February 2013
[2] Clause 6(5)(b) of the Competition Principles Agreement (CPA)

One of the functions of SA Water, as provided by the *South Australian Water Corporation Act 1994*, is to encourage and facilitate private or public sector investment and participation in the provision of water and wastewater services. Competition between private sector providers of capital projects and operational services has continued to play an important role in the delivery of water services by SA Water since the inception of the United Water and Riverland Water contracts in 1996.

Today the private sector provides around 90% of SA Water's capital projects and accounts for more than half its operating expenditure through processes that involve competitive selection such as tendering and private partnerships.

In addition, SA Water has demonstrated an acceptance of third party access arrangements in the past by voluntarily entering into a bulk water transport arrangement with Barossa Infrastructure Limited (BIL), off-peak bulk water supply agreements with irrigators, sewer mining arrangements with the City of Tea Tree Gully and Port Augusta and provisional transportation arrangement with Clare Valley irrigators.

Marsden Jacob Associates specifically noted that the BIL scheme involved significant upgrading of the SA Water system in order to assist BIL "*and goes beyond a simple third-party access regime*"[3] in a research paper on Third Party Access to Water and Wastewater Infrastructure in 2005 (Marsden Jacob paper) proving that successful negotiations can occur without the existence of complex and potentially costly access regimes.

Such bulk water transport arrangements are possible, because in South Australia, unlike major urban water supplies elsewhere in Australia, any party can source large quantities of water for extraction through active water markets in the Southern Murray Darling Basin (SMDB) system, and use SA Water's infrastructure to transport it to locations within the network. In 2010-11, for example, trade in water rights in the SMDB[4] comprised 3,126 GL of annual allocations and 773 GL of permanent entitlements (for comparison purposes SA Water drew 90GL from the River Murray in that year). The availability of water from access to a large active water market satisfies a very important condition for the development of competition in water supply as substantial quantities of bulk water are readily accessible, and subject to competition. SA Water has no strategic advantage in this area and there are no competitive barriers in the SMDB market.

SA Water envisages that the access regime would be designed so that benefit to the public and water industry is maximised, with increased innovation through competition and diversification of water sources, at minimum cost. SA Water has considered the Report with this in mind. In its submission, SA Water makes some general comments in relation to the key governing principles for determining scope of access and policy risks associated with water and wastewater network access that may warrant extensive policy consideration by the Government. In addition, the appendix to this submission contains SA Water's comments on each question posed in the Report.

[3] Marsden Jacob, Third Party Access in Water and Sewerage Infrastructure : Implications for Australia, 22 December 2005, p. 22

[4] National Water Commission, Australian Water markets: trends and drivers 2007-08 to 2010-11, p 72

2 Approach for access to water and sewerage services

The requirements for third party access to be enforceable are broadly similar across the three alternative pathways under Part IIIA of the CCA[5]. Clause (3) of the Competition Principles Agreement (CPA) makes certification of a state or territory access regime conditional on the regime applying to services provided by means of significant infrastructure facilities where:

- it would not be economically feasible to duplicate the facility;
- access to the service is necessary to permit effective competition in a downstream or upstream market; and
- the safe use of the facility can be ensured at an economically feasible cost.

SA Water considers development of an internal access regime which would aim to establish the scope of access arrangements, the negotiation and dispute resolution process, confidentiality arrangements and importantly a pricing methodology, is the least cost option for development of access to SA Water's infrastructure and the option best-placed to address the pricing distortions and social policy issues that add complexity to the process. SA Water acknowledges that a balance must be struck: the process of agreeing access to a network infrastructure owner's (service provider) supply system should be sufficiently underpinned by a comprehensive framework, but should also have a degree of flexibility. An internal SA Water regime would enable this balance. However, SA Water acknowledges that applying an internal SA Water access regime approach to non-SA Water infrastructure may be complex and would require further detailed consideration by the Government. Creating a regime that will apply to all water industry entities in South Australia would achieve a consistent regulatory framework for access to water and sewerage infrastructure in the State. A state-based access regime should enable service providers and access seekers to have some flexibility to deal with contractual and customer specific issues within access agreements. This view is consistent with clause (4) of the CPA which sets out a number of minimum criteria that must be incorporated within the access regime.

Interstate case studies show that a staged, transitionary approach to access is preferred. In considering the complexities associated with establishing legislation for third pary access arrangements, the Essential Services Commission of Victoria (ESC Vic) recommended a staged approach to develop an access regime, with the first stage requiring water businesses to make "access commitments" prior to the legislated regime being enacted[6]. The ESC Vic considered *"that proceeding straight to developing a comprehensive, legislated access regime could run the risk of 'locking in' poorly designed arrangements that do not achieve the Government's objectives for an access regime"*[7]. The ESC Vic also considered that the approach *"will minimise implementation costs while avoiding unnecessary delay in opening up greater opportunities for participation in the water sector"*[8].

[5] Access to an infrastructure service can be given effect:
- by declaration of a service by the relevant minister;
- through an access undertaking, made to and accepted by the Australian Competition and Consumer Commission; or
- by certification as effective of a state or territory access regime by the National Competition Council.

[6] ESC Vic, *Inquiry into an Access Regime for Water and Sewerage Infrastructure Services—Final Report, Volume I: Findings and Recommendations*, September 2009, p. 1

[7] Ibid, p. 10

[8] Ibid, p.11

The first state-based regime for third party access to water and wastewater infrastructure has been introduced in New South Wales, under the *Water Industry Competition Act 2006*. Under this regime, the terms and conditions of access are assessed on a case by case basis. This includes whether or not to grant access.

A recent United Kingdom Government White Paper (December 2012)[9] has identified a number of water sector reforms to address regime shortcomings and has made recommendations for an "evolutionary" approach. It has also ruled out requiring the legal separation of water companies' retail businesses (after almost two decades of third party access and competition in the sector).

The Marsden Jacob paper noted, with regards to the mature United Kingdom access regime, that "*... introduction of competition into the water industry of England and Wales...has not, to date, had significant effect on the industry. Despite the size of the UK industry, there have been relatively few applications for inset appointments*"[10].

Historical evidence shows that a gradual transition approach is more appropriate for introducing third party access regimes in an attempt to avoid unintended adverse outcomes and minimise potential costs to industry and general public.

SA Water is supportive of an incremental approach to access reform to enable evolution of policy matters and review of arrangements in light of experience, as well as evaluation of the likely costs and benefits of subsequent access reform measures. In addition to substantiation of potential benefits of access, rigorous examination and analysis of the potential costs to the public through either reduced levels of efficiency or dilution of economies of scale, should accompany introduction of any access reform.

SA Water notes that many issues will be finalised during the Bill drafting and implementation stage and detailed and ongoing consultation with water businesses will be critical throughout this stage. In addition, significant attention will need to be given to the drafting of detailed access agreements, which will become contracts between the service provider and the access seeker, and to standard terms and conditions of access to reflect any specific issues.

SA Water supports an incremental approach to implementation of a state-based third party access regime, refined over time.

[9] HM Government, *Water for Life*, December 2011

[10] Marsden Jacob, *Third Party Access in Water and Sewerage Infrastructure: Implications for Australia*, 22 December 2005, p. iv.

3 Scope of state-based access regime

3.1 Infrastructure covered by state-based access arrangements

SA Water is supportive of the proposed criteria for scope determination, in line with the guidance provided by clauses (3) and (4) of the CPA. Advocating a wide scope in the early phase of implementing an access regime would be premature, out of sequence with the broader scope of retail reforms and unlikely to be cost effective. An incremental approach, as discussed in section 2 of this submission, would ensure that access is considered in the context of a broader reform agenda to deliver better outcomes for customers and the environment, as well as achieving the full potential of an access regime.

SA Water supports an initial access regime providing access to:

- bulk water major pipelines and water distribution pipelines; and
- bulk and local wastewater transportation network.

The report raises a further question about the inclusion of ancillary services such as storages and treatment plants in the scope of state-based access regime. This question is considered below.

Clause (3) of the CPA makes certification of a state or territory access regime conditional on the regime applying to services provided by means of significant infrastructure facilities where:

- it would not be economically feasible to duplicate the facility;
- access to the service is necessary in order to permit effective competition in a downstream or upstream market;
- the safe use of the facility can be ensured at an economically feasible cost; and
- if there is a safety requirement, appropriate regulatory arrangements exist.

SA Water considered the meaning of 'not economically feasible to duplicate' in the context of interpreting the equivalent requirement in the criteria for declaration of an infrastructure service under Part IIIA of the CCA. Criterion (b) requires that it be uneconomical for anyone to develop another facility to provide the service. Each criterion for declaration cannot be interpreted in isolation from each other criterion. As a consequence the meaning of criterion (b) has been considered in the context of the meaning of criterion (f) – that access (or increased access) to the service would not be contrary to the public interest.

The three primary interpretations of 'uneconomic' as applied by the National Competition Council (NCC), the Australian Competition and Consumer Commission (ACCC) and the courts are:

- it would not be profitable for anyone to develop the facility ('privately profitable');
- the total net costs (where costs include production and social costs) exceed the total net benefits (where benefits include production and social benefits) of developing another facility ('social benefit'); or
- a single facility can meet market demand at a lower cost than two or more facilities providing the service ('natural monopoly').

The New South Wales access regime is the only jurisdiction that has a certified access regime applying to water and sewerage infrastructure and it includes water and sewerage treatment to the extent that it is inseparable from the provision of the infrastructure services; otherwise it is expressly excluded from the regime. IPART's recent consideration of the access undertaking proposed by

Sydney Water suggests that water treatment might have been considered separate if there were sufficient time within which it was economical to duplicate the facility. In light of the High Court decision, this would likely now require consideration of the private profitability of providing such infrastructure.

Under the New South Wales state-based access regime legislated under the *Water Industry Competition Act 2006*, the following additional criteria are included:

> *(a) that the infrastructure is of State significance, having regard to its nature and extent and its importance to the State economy,*
>
> *1. that access (or an increase in access) to the service would not be contrary to the public interest.*[11]

Similar considerations may be warranted for South Australia, reflecting the national competition principles with further regard to the size and likely significance of state infrastructure.

In Victoria, the ESC Vic chose to adopt a coverage formulation similar to the New South Wales access regime.

Furthermore, SA Water believes that water or sewerage treatment facilities could be considered as part of the production process (discussed in section 3.3 below) because it involves the transformation of water from non-potable to potable, and sewage from raw to different levels of treatment in accordance with environmental requirements. The rationale for the production process exemption is to prevent access to facilities simply because it is more convenient for a new entrant to use a competitor's infrastructure to compete in a downstream market.

SA Water does not consider treatment plants and storages to be a natural monopoly infrastructure. These facilities may be privately profitable to duplicate and there are different costs of production for competitors in that market, hence they should be excluded from the scope of state-based access regime.

SA Water recognises that in some situations, where it becomes evident that reproduction of treatment facility may not be economically feasible, separate commercial negotiations for access to water treatment plant may be required.

Whilst increasing the potential sources of treated water into SA Water's reticulated system increases the likelihood of water quality risk, SA Water believes this risk can be appropriately managed through careful design of the access regime and access contracts and appropriately designed management processes and monitoring programs. However, this must be in strict compliance with the requirements of the Department of Health and Ageing.

To avoid application of the regime for unintended purposes, SA Water supports the proposed scope recommendations to include bulk and distribution water transportation infrastructure and bulk and local sewerage transportation infrastructure, in line with the guidance provided by clauses (3) and (4) in the CPA.

Consideration should be given to including further criteria in the state-based access regime to protect public health, safety and the environment.

[11] *Water Industry Competition Act 2006* (NSW), section 23

3.2 Eligibility thresholds

Consistent with the Government's intention not to introduce full retail competition in the short term[12] and recognising the potential administrative costs of assessing and granting access to third parties, SA Water proposes eligibility thresholds for access arrangements. Competition in the United Kingdom is limited to non-residential customers who meet minimum volumetric requirements. As in the United Kingdom, an eligibility threshold could apply as a transitional measure and could be eased as more knowledge develops regarding the costs and risks associated with access, and the appropriate management of these costs and risks.

In the first instance, it could be appropriate to limit eligibility to business customers and/or to access seekers looking to inject a certain quantity of water into SA Water's network. However, SA Water recognises that the access pricing arrangements in these instances will need to be considerate of protecting remaining residential and/or low volume customers who will be required to pay retail prices as determined by ESCOSA's revenue determination.

Consideration should be given to the requirements that must be satisfied prior to eligibility for third party access or under a self-supply arrangement. In accordance with '*Water for Good*'[13] which specifies that full retail contestability will not be introduced initially, guidelines that may be set include the following:

- the customer's premises must be primarily for non-residential purposes;
- a total quantity of water estimated to be supplied annually must be no less than a specified volume; and
- each meter may only be supplied by one service provider.

The proposed inclusion of an eligibility threshold will reduce the risk of unintentionally openning up a form of retail competition. The scope of access can be gradually extended subject to the assessement of net future benefits, as sucessfully demonstrated in the introduction of competition in the electricity market.

SA Water recommends the application of a third party access regime to non-residential customers who meet eligibility guidelines.

3.3 Defining the services being provided

In addition to defining the infrastructure within the scope of the access regime it is necessary to define the services being provided to the access seeker. The National Competition Council has required definition of the services covered by access regimes in both generic terms and by nominating particular facilities providing those services.

Third party access regimes are governed by Part IIIA of the CCA. The access regime set out in the CCA only applies to infrastructure used to provide a "service", which is defined in the following terms:

[12] Government of South Australia, *Water for Good*, June 2009, p. 149
[13] Government of South Australia, Water for Good – A Plan to Ensure Our Water Future to 2050, June 2009

Service means a service provided by means of a facility and includes:

(a) the use of an infrastructure facility such as a road or railway line;
(b) handling or transporting things such as goods or people;
(c) a communications service or similar service;

but does not include:

(d) the supply of goods; or
(e) the use of intellectual property; or
(f) the use of a production process;

except to the extent that it is an integral but subsidiary part of the service.

Under these guidelines SA Water considers it appropriate to include the following distinct services:

- capacity reservation; and
- transportation service.

Reserving capacity in the system comes at an opportunity cost to the service provider and these costs need to be recovered whether or not the access seeker actually transports water. The Sydney Water Access Undertaking largely discusses this in terms of water network services but does not specifically address capacity issues. In comparison, other industries focus heavily on the capacity to be reserved within the system and discuss aspects such as capacity contracting models and queuing policies.

An ongoing transport service cannot be offered without reserving capacity. In order to reserve the capacity required the service provider would need to be compensated for the opportunity cost of that capacity reservation as well as recovering the marginal costs of supplying the transport service. One-off transportation services would not involve ongoing capacity reservation. Terms and conditions of such access arrangements should not be limited by state-based access requirements but based on commercial negotiations between the parties involved.

From an operational and risk management perspective, an access seeker should not be able to transfer their right to system capacity and the transport service to any other party without the formal prior written agreement of the service provider.

A State-based access regime should include definition of the services provided by means of the infrastructure within the scope of the access regime.

One-off transportation arrangements should be negotiated on commercial terms outside of scope of the state-based access regime.

Access seekers should not be able to transfer their right to system capacity and the transport service to any other party without the formal prior written agreement of the service provider.

4 Appointment of economic regulator

SA Water supports the Government's proposal for a 'light-handed' regulatory role given the potentially lower administrative costs and the likelihood that there will be a limited number of applications for access.

An access regime seeks to facilitate interactions between infrastructure providers and potential access seekers where access is required to compete in a related market. In general, any access arrangement requires consideration of the terms and conditions upon which access will be provided, including both price and non-price terms. The CPA requires that:

> *6(4)(g) Where the owner and a person seeking access cannot agree on terms and conditions for access to the service, they should be required to appoint and fund an independent body to resolve the dispute, if they have not already done so.*

As a consequence, the only regulatory requirement that must be included in a state-based access regime under the CPA is the scope for the appointment of a dispute resolution body. There is no requirement that a regulator be appointed to provide guidance on the terms and conditions of access. As a consequence, if a regulator is given powers within a regime there should be a clear assessment of the benefits and costs of doing so.

Any role for a regulator within an access arrangement should therefore take into consideration:

- the desirability of minimising administration and compliance costs for the access seeker, service provider and the regulator; and
- the scope for the access price structure and service quality outcomes to be consistent with those that would be achieved if the infrastructure service were provided in a workably competitive market.

Additionally, powers given to an economic regulator, without appropriate government controls to manage social policy issues that are outside of economic regulator remit, would allow a purist economic theory to potentially undermine social policies and disadvantage those customers that are most vulnerable. Ultimately the regime regulator should have a minimal role, if any, in the setting of price and non-price terms and conditions if a negotiation/arbitration approach will result in appropriate access outcomes.

Relevant to this assessment is a consideration of the administrative costs of an alternative 'heavy-handed' regulatory approach. An indication of the possible regulatory costs can be provided by examining the general cost of complying with economic regulation by water businesses. For example, the South-East Queensland Council of Mayors indicated that the cost of a price monitoring report produced by the Queensland Competition Authority cost in excess of $2 million[14]. Similarly, IPART has indicated that the direct regulatory costs for a typical water price review is around $360,000, while general water regulation represents approximately one quarter of IPART's overall budget, or $5 million each year[15].

There are different roles ascribed to regulators across various access regimes operating in Australia.

[14] Productivity Commission, *Australia's Urban Water Sector, Report No. 55, Volume 1*, August 2011, p. 315
[15] Ibid.

Within the New South Wales water and sewerage access regime, IPART is responsible for:

- administering the licensing regime for water retailers and network operators;
- assessing applications for coverage of infrastructure assets within the scheme to the relevant Minister;
- administering an access register;
- acting as an arbiter for any disputes arising from the access regime; and
- approving any voluntary access undertakings made by an infrastructure supplier.

Allocating these responsibilities to IPART allows it to manage water quality and environmental concerns that might arise as a consequence of competition, while minimising regulatory administrative costs. By the regime allowing for optional undertakings to be developed for incumbent infrastructure providers, flexibility has been created for the scheme to evolve and provide greater certainty about the terms and conditions of access as competition develops over time.

The ESC Vic identifies a number of regulatory functions for the Victorian regime, namely[16]:

- approving or rejecting applications for declaration of specific infrastructure services and approving or rejecting access undertakings proposed by infrastructure operators;
- establishing an effective negotiation framework and arbitrating in access disputes;
- developing access pricing principles, setting reference access prices (where appropriate) and establishing a ring fencing framework;
- granting or rejecting licence applications and monitoring compliance with licence conditions;
- monitoring and reporting on the performance of new water and sewerage service providers and the operation of the access regime; and
- monitoring and reviewing the effectiveness of the access regime.

SA Water considers that there may be a monitoring role for the economic regulator within the scope of a light-handed regime that facilitates commercial negotiation and arbitration. However, arbitration of disputes that may arise should be undertaken by an independent body that can make impartial decisions with regards to rules that ESCOSA may set as the regime's economic regulatory body and also to give regard to non-economic matters. Consideration should be given to including a requirement in the state-based access regime, that the appointed arbitrator be selected from a panel of arbitrators, agreed by the access seeker and the service provider.

SA Water supports light handed regulation by the regulatory body which may be supplemented by the Government's regulatory/pricing orders to ensure unintended social policy outcomes are minimised.

The selection of arbitrator should be agreed between the access seeker and the service provider, and must be based on technical knowledge (including health, safety and the environment where relevant), commercial expertise and industry knowledge.

[16] ESC Vic, *Inquiry into an Access Regime for Water and Sewerage Infrastructure Services, Final Report Volume II: Analysis and Discussion of Issues*, September 2012, p. 131

5 Legislated conditions of access

The state-based access regime should provide a framework that establishes clear responsibilities between the customer, the infrastructure service provider and access seeker.

5.1 Objects Clause

It is common for access legislation to have an objects or objectives clause to outline the intent of the document and provide clarity for service providers and access seekers. Some examples are provided on page 13 of the appendix and include the CCA, Part IIIA section 44AA, Part 3 of the *Water Industry Competition Act 2006* in NSW and Sydney Water's Access Undertaking.

The Sydney Water example appears to contain the most comprehensive set of objectives, providing clarity for both access seeker and service provider. While sections (a) to (d) and section (f) largely mirror the intent of the CCA provisions, sections (e) and (g) provide clarity of the intent and there is merit in considering inclusion of similar clauses within the state-based access regime. These clauses would need to be amended to reflect South Australian Government policy intentions.

State-based access legislation should include an objectives clause which captures the intent of section 44AA of the CCA and sections 1.2(e) and (g) of the Sydney Water Access Undertaking.

5.2 Queuing Policy, Proposed Contracting Model

To avoid disputes regarding the rights of access seekers to negotiate reservation of capacity many industry access regimes outline the contracting model and provide a queuing policy which outlines the rules for assessment of third party access applications where multiple applications are received for limited available capacity. Some of SA Water's infrastructure is at or near capacity and the state-based access regime should consider outlining policy guidelines on capacity contracting.

A contract carriage model is a system of managing third party access whereby:

- the service provider manages its ability to provide services by requiring users to enter into a contract that specifies a quantity of service;
- users are normally required to not use more than the quantity of service specified in a contract;
- charges for use of a service are normally based, at least in part, upon the quantity of service specified in a contract.

The gas market in South Australia is based on a contract carriage model with bilateral contracting arrangements for the physical transport of gas from producers to consumers. Gas users contract with producers for gas supplies and with pipeline system owners for transport services who have traditionally underwritten pipeline investment through long term contracts.

The physical nature of water and the cost structure for transporting water appears to have more similarity with gas (i.e. fixed source, high transport costs through large pipeline). Furthermore, the current structure of the water industry in South Australia is not considered mature enough to progress to the alternative more complex wholesale market model. The Sydney Water Access Undertaking and the United Kingdom access codes appear to have terms and conditions consistent with the contract carriage model. They are negotiate/arbitrate models which require an access application and preliminary assessment of the availability of the network services by the service provider. On this basis, a contract carriage model consisting of longer term capacity contracts appears appropriate in the current South Australian water industry.

Under a contract carriage model, it is prudent to have a queuing policy, where all access seekers are treated equitably and fairly. In the gas industry a queuing policy is a specific requirement under the National Third Party Access Code for Natural Gas Pipeline Systems. Specifically, Regulation 3.13 requires:

The Queuing Policy must:

- *(a) set out sufficient detail to enable Users and Prospective Users to understand in advance how the Queuing Policy will operate;*
- *(b) accommodate, to the extent reasonably possible, the legitimate business interests of the Service Provider and of Users and Prospective Users; and*
- *(c) generate, to the extent reasonably possible, economically efficient outcomes.*

There are other industry examples of queuing policies such as those related to Western Power and Queensland Gas.

SA Water considers a high level queuing policy is appropriate to be included in the state-based access regime and that it should work on the principles of 'first in first served'. 'First in' may be assessed as the date the initial application is received by the service provider's contact officer[17]. There must also be provision for how a service provider should assess its own prior interests in that capacity.

Consider inclusion of policy guidelines on capacity contracting (contract carriage model) in the state-based access regime.

Consider inclusion of high level queuing policy in the state-based access regime, that should work on the principles of 'first in first served'.

[17] Applications would need to be substantially complete and all conditions precedent met e.g. the applicant would need to hold a retail licence or have indicated their intention to apply for a retail licence.

5.3 Application to existing access arrangements

SA Water considers it would be appropriate for the state-based access regime to include provisions in relation to access agreements in place prior to application of a state-based regime. One example of such clause is incorporated in Sydney Water's Access Undertaking which provides that the undertaking does not apply to the negotiation of any access agreement which has a commencement date before IPART approves the undertaking or after the expiry of the undertaking. It would be appropriate for state-based access regime to include similar provisions.

Consider including 'exemption' clauses in a state-based access regime to provide for arrangements entered into prior to the commencment date of the regime as well as after the expiry of the regime.

5.4 Negotiation and dispute resolution framework

SA Water supports the application of an access negotiation and dispute resolution framework similar to that provided under the *Railways (Operations and Access) Act 1997*. An analysis of the practical application of the various aspects of the *Railways (Operations and Access) Act 1997* is set out in the relevant section of the appendix to this submission, with recommended modifications to suit the conditions of the water industry. Key suggestions relate to creating a level playing field for service providers and access seekers by the inclusion of obligations for access seekers to provide adequate information to enable assessments by the service provider.

Furthermore, SA Water considered the IPART Negotiation Protocols (refer attachment) and is of the opinion that these convey further rights and obligations on both service providers and access seekers that in turn facilitate negotiations in good faith as well as efficiency. In order to avoid escalating costs of access negotiation and dispute resolution being incurred by either party and therefore their customers, state-based access legislation for the South Australian water industry would benefit from provision of the following steps prior to referral to a regulator/arbitration:

1. Internal escalation; and
2. Private mediation.

SA Water would support the inclusion of provisions similar to those in the IPART Negotiation Protocols to allow for clear negotiation protocols and stepped negotiation and dispute resolution processes.

SA Water supports establishment of a clear negotiation and dispute resolution framework, that could be modeled on the Railways (Operations and Access) Act 1997 and the IPART Negotiation Protocols, with consideration given to practical implementation, creating fair terms of negotiation and cost minimisation in the South Australian water industry.

5.5 Other Terms and Conditions of Access

5.5.1 Pricing Principles and Methodology

SA Water supports the establishment of guiding pricing principles that accord with the requirements set out in clause 6(5)(b) of the CPA. To create an environment where efficient participation can occur, where an access seeker is at least as efficient as a service provider, would mean creating a level playing field for all participants to ensure competition does not simply develop by one competitor not having to satisfy the same obligations. It would also mean that the access regime would need to ensure that all customers (whether or not they benefit from the access arrangement) continue to benefit from the state's social policies. As such, any guiding principles for access pricing should take the considerations set out in the discussion below into account.

Increasing competition in the water sector in the current environment would raise risks associated with retail prices which do not reflect the cost of supply for individual customers. Policies which contribute to this risk include:

- the State-wide pricing policy whereby retail prices fundamentally average whole of network costs, including the cost of water security and subsidies (e.g. Community Service Obligations for country customers and cross-subsidies within country and metropolitan segments);
- the application of property value based charges for commercial customers and for wastewater services;
- the use of inclining block tariffs; and
- recovery of investment in water security which has been a significant driver of SA Water's costs, asset base and hence customer prices.[18]

ESCOSA's retail pricing inquiries and recommendations to the government may result in reforms of retail pricing which may require adjustment to the proposed access pricing approach in the future. It is SA Water's view that access pricing principles should be complementary and consistent with the retail pricing policies. Future reform to access pricing should be made in line with retail pricing reforms to avoid unintended outcomes for residential customers and to avoid influence on ESCOSA's pending inquiries. This approach would ensure that the objective of encouraging efficient competition will not be undermined and the service provider and access seekers will be able to compete on equal grounds.

As SA Water's retail service prices are informed by an allowable (efficient) annual revenue requirement as determined by ESCOSA, resulting retail charges have to be based on efficient levels of costs. As this eliminates the risk of 'monopoly rents' in retail pricing, retail prices are a sound and equitable basis for setting access prices.

A similar approach has been successfully demonstrated in Scotland where default retail tarriffs are set at the level Scottish Water (the monopoly infrastructure owner) would have charged if competition had not been introduced. This approach would provide an imperative safety net for all customers so that no customer is worse off because of competition.

[18] NERA Economic Consulting, *Assessment of Third Party Access Arrangements in South Australia*, 5 January 2012, p. iii

A review of access arrangements in the water sector in other jurisdictions further identified a general trend towards access pricing being linked to retail pricing, as follows:

- ESC Vic recommended that in most cases access prices should be determined using a "retail minus" methodology[19];
- United Kingdom Access Code Guidance requires appointed water companies in the United Kingdom to offer a discount from the standard retail tariff[20] (retail minus); and
- New South Wales commenced with retail minus access pricing arrangements under the Sydney Water declaration but has moved towards a cost of service approach in the New South Wales state-based access regime[21]. The more recent Sydney Water Access Undertaking moves a step further proposing a "cost-building block plus methodology"[22] which effectively adds back the cost of water security to the costs of transport. However, the successful application of this approach is yet to be determined.

To avoid any adverse impacts on residential customers and unintended social policy outcomes access pricing principles should be determined and implemented in a manner that is consistent with any relevant retail pricing reforms, determinations and pricing orders as issued by the Government and consistent with the requirements set out in clause 6(5)(b) of the CPA.

5.5.2 Water security investment

Recovery of water security investment is a key issue that may warrant specific legislation to address some of the practicalities that will otherwise be left to SA Water and access seekers to sort out, making the process of access negotiation difficult and drawn out.

SA Water supports the current government policy under which all customers contribute to the investment in water security through the inclusion of water security investment costs in state-wide retail prices.

This approach is also consistent with the broad principle included within Sydney Water's Access Undertaking which requires all customers, including access seekers, to fund water security investment. It should be noted that for Sydney Water this is mainly limited to recycling efforts and efficiency schemes.

Maintain the current government policy for funding the water security investment through inclusion of water security charges in both retail and access prices, potentially through legislation.

[19] ESC Vic, *Inquiry into an Access Regime for Water and Sewerage Infrastructure Services—Final Report, Volume I: Findings and Recommendations*, September 2009, p. 1

[20] OFWAT, *Access Code Guidance*, September 2011, p. 7

[21] NERA Economic Consulting, *Assessment of Third Party Access Arrangements in South Australia*, 5 January 2012, p. 33

[22] Sydney Water, *Water Network Access Undertaking Supporting Submission*, January 2012, p. iv

5.5.3 Provider of last resort obligations

Prior to access occurring, arrangements need to be made with respect to supplier and operator of last resort. Two types of last resort obligations exist:

- Operator of last resort – a situation where incumbent service provider is required to operate third party infrastructure to provide third party water resources to third party customers; or
- Supplier of last resort – a situation where incumbent service provider is required to source and supply water to third party customers (either through third party infrastructure or its own infrastructure).

Division 6 of the *Water Industry Act 2012* provides operator of last resort powers to ESCOSA in the event that a retail licensee contravenes the Act or its licence ceases. Section 39(1) empowers ESCOSA to appoint an operator to take over the relevant operations on agreed terms and conditions (including remuneration and indemnities). This provision would provide the appointed operator the ability to negotiate potentially different service standards, arrangements for the operation of potentially inferior infrastructure, etc. These provisions are considered adequate.

However the *Water Industry Act 2012* is silent on supplier of last resort obligations. From a state-based access regime perspective, there is no requirement for access seekers to ensure security of service to provide some protection to customers. The State-based access regime should include provisions that the customer must accept the level of water security obligations offered by their supplier.

In such circumstances, where a service provider (infrastructure owner) may be required to step in as a supplier of last resort, the access regime should provide for relevant process, terms and conditions, similar to provisions in the Water Industry Act for the operator of last resort situation.

The State-based access regime should include provisions that the customer must accept the level of water security obligatons offered by their supplier.

Consider inclusion of policy guidelines on supplier of last resort obligations, within the state-based access regime.

5.6 Public health, environmental and safety regulation

SA Water agrees that the regulation of standards for public health, environment and safety is well established in South Australia. Maintaining these standards on a consistent basis, for service providers as well as access seekers, through regulatory bodies with relevant expertise is paramount to the South Australian community.

As such, public health, environmental and safety standard regulators will need to be involved in the consultation leading to the drafting of state-based access legislation, to ensure all regulatory standards are adequately and clearly provided for. This is largely because it is proposed that only the economic regulator be involved in the access process thereafter; all industry relevant regulatory standards must be embedded in the access regime.

In line with the philosophy of creating an even playing field to foster effective competition in the water industry, all service providers and access seekers need to be consistently held to the appropriate health, environmental and safety standards relevant to the service being provided. The best way to ensure this is the case is to provide for these standards in the legislation, referencing regulatory standard documentation updated from time to time as required.

Section 90 of the *Water Industry Act 2012* does not specifically contemplate consultation between arbitrators and relevant regulators and is not adequate with regard to access matters. A specific provision within access legislation should be made for consultation between arbitrators and all relevant regulators should disputes arise over non-economic regulatory standards. However, the risk of such disputes arising will be minimised by ensuring there are clear legal obligations within access legislation which set out the relevant requirements for minimum standards for health, environmental and safety compliance.

The relevant regulatory documentation contains very clear standards and direction on many areas that may be areas of disagreement for parties negotiating access. As such, the most efficient means of negotiation, and the one which will provide the best public outcomes with regard to health, environment and safety, will be for minimum standards to be obligatory and referenced under the access regime.

SA Water would support clear legal obligations within the state-based access legislation with regards to all relevant regulatory matters for all parties involved in the access arrangements in order to:

- provide a level playing field and ensure all water industry entities are not compromising an appropriate level of service in order to gain entry to the market/market share;
- avoid unnecessary, costly and time consuming disputes over operational matters; and
- provide relevant and necessary regulatory input.

Consider specific provisions within the state-based access legislation to ensure that public health, safety and environmental obligations are not compromised and to ensure that relevant regulatory bodies continue to ensure that risks to public health and environment are managed appropriately.

SA Water supports the Government's proposal to maintain existing measures for public health, environmental and safety standards.

6 APPENDIX

6.1 Additional responses to individual questions

6.1.1 Has the current policy framework applying to SA Water for voluntary access arrangements been successful in promoting access to water and sewerage infrastructure?

SA Water continues to support commercial negotiations of access to its infrastructure. SA Water has established successful access arrangements in the past by voluntarily entering into a bulk water transport arrangement with Barossa Infrastructure Limited (BIL), off-peak bulk water supply agreements with irrigators, a sewer mining arrangement with the City of Tea Tree Gully and Port Augusta and temporary water transportation arrangements with Clare Valley grape growers.

Marsden Jacob Associates research paper on Third Party Access to Water and Wastewater Infrastructure specifically noted that the BIL scheme involved significant upgrading of the SA Water system in order to assist BIL "and goes beyond a simple third-party access regime", proving that successful negotiations can occur without the existence of complex and potentially costly access regimes to govern them.

Such arrangments are possible because in South Australia, unlike other states, any party can purchase large quantities of water from the Murray Darling Basin system and use SA Water's infrastructure to transport it to almost any location within the network. This satisfies a very important condition for the development of competition in water supply as bulk water is already subject to competition.

The Southern Murray Darling Basin (SMDB) market is a highly reliable source of low cost water, albeit the price is subject to market supply and demand forces. Notwithstanding the variability of supply and demand there has never been a circumstance when water was not available in SMDB markets, including the most recent drought. Indeed, during the recent drought, SA Water relied extensively on the SMDB water market to secure large volumes of water as a contingency to supplement its other sources of water, including from its Mount Lofty Ranges (MLR) catchments which were severely depleted as a result of near record low inflows. SA Water is not aware of any other large urban water supply access regime in Australia or overseas that operates in an environment like SA Water's, where any party has ready access to water markets with such an extensive and reliable source of water, on a scale of the SMDB market.

SA Water has no strategic advantage in this area and there are no competition barriers in the SMDB market, indeed the *Water Act 2007 (Commonwealth)* and the recent Basin Plan for the Murray Darling Basin contain specific mechanisms designed to ensure open markets free of barriers to competition, or restrictions on access to those markets. Section 42(2) of the *Water Act (2007)* requires that in developing water market rules in the Basin Plan, the Muray Darling Basin Authority must obtain and have regard to advice of the ACCC.

6.1.2 Should the policy framework for access arrangements apply to other water industry participants (in addition to SA Water)?

SA Water considers that the policy framework for access arrangements should have consistent application to all other water industry participants in order to create a fair and efficient environment to foster effective competition.

6.1.3 What are the costs and benefits of establishing a state-based legislative access regime?

Quantifying the impact of a state-based access regime would require factual data that at present may not be available. This would support the incremental approach to access in the water industry so that costs and benefits can be evaluated at each stage of implementation. Some of the costs that may be involved, such as administrative and compliance costs, would depend on the coverage of the regime and regulatory prescriptions. However, the government may have some insight into the costs of establishing South Australia's state-based access regimes for the rail and ports industries.

6.1.4 If a certified state-based legislative access regime is implemented, is it also necessary to work with the Commonwealth Government to exclude or displace the operation of the Commonwealth water charge regime under the *Water Act 2007* (Cth) from the areas of operation of the state-based legislative access regime?

The main purpose of establishing a state-based access regime for an industry, is to provide greater certainty, clarity and transparency for access seekers and infrastructure operators. The Government would be advised to further clarify how the Commonwealth water charge regime rules might apply to water extracted through SA Water infrastructure that is not for urban water supply.

If a state-based access regime is established in relation to the infrastructure used for SA Water's urban water supply activities, the interpretation of what constitutes a regulated water charge under the *Water Act 2007* should be clarified and agreed with the Commonwealth. Otherwise the infrastructure used to supply urban customers may also be subject to the Water Charge Rules under the *Water Act 2007* (Cth). This situation is considered impracticable as it:

- could result in two sets of regulatory and pricing arrangements;
- would have significant implications for allocating the costs of shared infrastructure and hence impacts for costing systems;
- could potentially result in some instances where charges would need to be separated into components depending on applicable regulatory compliance requirements, resulting in increased administrative costs; and
- could have unintended impacts for the application of the State-wide pricing principle.

SA Water supports action which would resolve the regulatory uncertainty for relevant charges and would be pleased to provide further information where this would assist in clarifying the application of the *Water Act 2007* to SA Water's charges.

6.1.5 What should the scope of a state-based legislative access regime be?

Refer to section 3 in the main submission.

6.1.6 Should the scope include bulk water transport, water distribution transport, local sewage transport and bulk sewage transport?

Refer to section 3 in the mains submission.

6.1.7 Should ancillary services, such as water storages and treatment plants, be included within the scope of a state-based legislative access regime? If yes, on what criteria?

Refer to section 3 in the main submission.

6.1.8 Should ESCOSA's role as the industry regulator for water be extended to include a state-based access regime?

Under the *Water Industry Act 2012*, ESCOSA is appointed as the economic regulatory and licensing authority for retail water and sewerage services. SA Water is of the opinion that ESCOSA is best placed to become the economic regulator for third party access. However, arbitration of disputes that may arise should be undertaken by an independent body that can make impartial decisions with regards to rules that ESCOSA may set as the regime regulatory body and also to give regard to non-economic matters.

6.1.9 Should the regulator be required to adopt a light handed regime (of monitoring, commercial negotiation and arbitration)? Is this sufficient? Or is a heavier handed regulatory regime required?

Refer to section 4 in the main submission.

6.1.10 How should the initial assessment of which specific water and sewerage infrastructure services a state-based access regime should apply to, be undertaken?

For the avoidance of doubt, the application of a state-based access regime should be determined at the development of the framework and specifically outlined in legislation. This will aid the avoidance of unnecessary disputes and inefficient processes that do not immediately preclude ineligible infrastructure.

Much of this work has been put forward in the Report and it follows that a legislative solution to access in South Australia should continue this path. However, if the government wished to be less prescriptive at a minimum it would need to provide stringent criteria for eligibility and schedules of eligible areas/infrastructure as outlined in the New South Wales *Water Industry Competition Act 2006* (WICA).

Consistent with recommendations in section 3 of the main submission, eligible infrastructure as outlined in the Report should be explicitly provided for in state-based access legislation.

6.1.11 What criteria should be adopted for the initial assessment?

Criteria consistent with the national access framework established under the Competition Principles Agreement and legislated through the *Competition and Consumer Act 2010* (Cth) should be adopted – as discussed in the main submission section 3.

Section 6(2) of the CPA further provides that for a state-based regime to be deemed effective it should apply to services characterised by (a), (b) and (d) i.e. the facility does not need to be of national significance with regard to size and constitutional trade or commerce.

Under the New South Wales state-based access regime legislated under the *Water Industry Competition Act 2006,* the following additional criteria are included (including the reappearance of the significance test but with regard to State significance):

(a) that the infrastructure is of State significance, having regard to its nature and extent and its importance to the State economy,

(e) that access (or an increase in access) to the service would not be contrary to the public interest.[23]

[23] *Water Industry Competition Act 2006* (NSW), section 23

SA Water recommends that the New South Wales approach be adopted in South Australia because it reflects the national competition principles with further regard to the size and likely significance of state infrastructure.

In addition to the legislative criteria set out in the main submission and the common law tests, the following commercial tests should apply in order to ensure only efficient and effective competition is fostered by the regime:

- Business case type assessments of a proposed venture to determine:
    - propensity for increased competition;
    - efficiency of the proposal and therefore of increased competition;
    - social benefit of increased competition (linked to efficiency and therefore customer or social outcomes);
    - effectiveness of the proposal in achieving the objectives of the Competition Principles Agreement and Part IIIA of the Competition and Consumer Act 2010 (some of which are captured above);
- cost-benefit analysis similar to that undertaken by the Economic Regulation Authority of Western Australian in its inquiry into alternate water supplies for Kalgoorlie-Boulder; and
- capacity assessment (including consideration of future efficient use by the infrastructure owner).

Consistent with recommendations outlined in Section 3 of the main submission, with additional commercial tests that should be applied on a case by case basis to ensure only efficient and effective competition is fostered by the regime.

6.1.12 Over time, how should the initial assessment of the application of the state-based access regime be reviewed?

An access regime should be carefully researched, planned and all aspects addressed including complex areas of access that have yet to be resolved in the global arena such as effective pricing methodologies that take account of social pricing policies, wider customer interest and various imperfections of the market that does not allow for the application of pure economic theories if the overall ambition is to achieve a desirable outcome. A staged implementation process is recommended with appropriate time being taken to address all of the issues.

Aspects of the regime should be updated (or implemented for the first time) when international and interstate experiences develop and South Australia can benefit from additional information and proven outcomes.

An access regime should be periodically reviewed for effectiveness and, if proven ineffective, a cost-benefit analysis of the regime should be conducted and other alternative methods should be investigated (such as returning to less formal measures where entities conduct access negotiations on commercial terms and resolve disputes in line with any usual commercial dispute where national legislative protections are in place).

Case study example: current review of third party access framework in the United Kingdom as a result of acknowledgement that the regime has been relatively ineffective and largely unused[24].

Given international and interstate experience with formal access regimes, and the costliness of development, implementation and administration, a review should be conducted to determine the effectiveness and efficiency of the regime. Alternative options should be explored (such as less formal, commercial processes) if the cost-benefit analysis of a regime does not support its development or continuation.

6.1.13 What time frame is appropriate for the periodic review of a state-based access regime?

SA Water would support 5 year reviews of the access regime, in line with the guidelines in Clause 6(4)(d) of the CPA.

6.1.14 Should the review be undertaken by the regulator? If not, who should be responsible for undertaking the review?

It may be inappropriate for the economic regulator to review the access regime, depending on what role it may play in establishing and determining terms and conditions associated with the regime. There may be a conflict of interest and as such an independent party should be appointed for review.

6.1.15 Does the Railways (Operations and Access) Act 1997 provide a good basis for the negotiation framework for a state-based access regime?

Reference	Recommendation for application to water industry
Division 1 – Pricing Principles	Please refer to comments at section 5 in the main report..
Division 2 – Information about access, section 28	Section 28 is appropriate in its entirety with the exception of the requirements under section 28(1). The information is not applicable to the water industry. It is recommended that this section provide for the provision of information required under the IPART Negotiation Protocols, specifically: 1. Information regarding the infrastructure services the Access Seeker has expressed interested in[25];

[24] HM Government, *Water for Life*, December 2011
Marsden Jacob, *Third Party Access in Water and Sewerage Infrastructure : Implications for Australia*, 22 December 2005

[25] This provision has been amended from a broad list of services covered by a coverage declaration or access undertaking due to the inexistence of those instruments in South Australia but also to provide clear direction on what the first step (information request) should constitute. This should be a two step process whereby initial information is sought but still of a specific nature that allows the Service Provider to provide the relevant information required at

	2. the further process to negotiating access and the likely timing (assuming the matter does not go to arbitration) including protocols such as negotiating in good faith; 3. the procedure the Service Provider will apply in determining a request for access to infrastructure services; 4. a copy of the Service Provider's access undertaking (if applicable); 5. a copy of the Service Provider's pricing principles for the relevant infrastructure services (if applicable or generic pricing principles if not yet applicable); 6. a copy of any standard access agreement (if applicable); 7. the contact details (including fax, telephone and email) of the Service Provider and the name and contact details of the Service Provider's representative who is the initial point of contact for responding to questions from Access Seekers prior to the lodgement of an Access Request and to whom an Access Request may be addressed; and 8. such other information as the Service Provider considers appropriate to include in the package.
Division 2, section 29	Section 29 is mostly appropriate but it should be made sufficiently clear that the step set out in section 29 is a separate step to the step set out in section 28 and is in line with the Access Request and Preliminary Assessment steps referred to in the IPART Negotiation Protocols. With regards to provision of information about current utilisation of infrastructure, SA Water's available capacity is not static. It varies according to the time of the day, the time of the year, maintenance requirements, strategic pumping requirements, customer growth, distribution and water use patterns, climatic conditions, augmentations and operational requirements such as managing unplanned outages and emergencies. Decisions regarding spare capacity at any point in time are complex and need to be considered on a case by case basis. SA Water is already experienced at assessing demands for new capacity on its systems particularly through development connection applications, which require a decision within 6 weeks. A similar process should be implemented for access seekers. In line with a suggested three step process for assessment – initial inquiry, application and assessment and decision, a service provider should have the obligation to provide an indicative assessment of capacity availability at the Initial Inquiry phase and the final decision on capacity at the Application Assessment phase. This would be dependent upon the appropriate information being made available in the applications. The service provider should have the final decision in regards to available capacity subject to transparent negotiation and arbitration processes. The service provider should also have the right to offer a lower capacity in the event that the full request for capacity is not available and to stipulate and terms and conditions which may apply to the reservation of capacity (e.g. only reserved at certain times of the day or year, etc.).

the first step and then the process proceeds to the second step where an Access Request is made and the Service Provider responds with a Preliminary Assessment. This process streamlines the initial steps and provides for a much more efficient process.

	In addition, in order for the Service Provider to provide the information set out in section 29(1) in response to an Access Request there must be adequate provision for the information the Access Seeker must provide in its Access Request. Access Requests should be accompanied by the payment of a fee which accurately reflects the resources required to adequately respond to the Access Request (section 29(2) and (3)). Each Service Provider should be able to determine this fee based on the real costs of the resources involved – Service Providers of varying sizes will ultimately have varying fees because it logically follows that larger Service Providers will need to assess the capacities of complex infrastructure and dependencies, have greater requirements with regard to investigating the technical and economic feasibility of potential extensions or additions to networks etc.
Part 5 – Negotiation of access, section 31	The general provisions of section 31 appear appropriate however, the articulation of the steps involved in initiating and negotiating an access agreement could be made clearer. It is suggested that the various obligations on Access Seekers and Service Providers be set out in line with the process detailed in the IPART Negotiation Protocols (see Attachment). There may be merit in defining different timings for the access application process for standard and non-standard services. The Sydney Water Access Undertaking uses a standard and non-standard service approach however this is designed to deal with those services subject to the standard access agreement and those which would be subject to separate negotiations. SA Water does not support section 31(3) as this provision is not in line with the principles of light-handed regulation and adds additional costs and delay to the process which is ultimately not in the best interests of customers or Access Seekers. It is recommended that, in line with light-handed regulation, a copy of the final access agreement be forwarded to the regulator for its information not more than 14 days post-execution between the parties. Prior notification to the regulator will only occur when a dispute has arisen and the matter is being referred to the regulator for mediation or to an arbitrator for arbitration. SA Water does not support section 31(3)(b), 31(4)(b) and any other provisions that give rise to a right for external parties to participate in the negotiation process. The water industry in South Australia is distinct from the rail industry where access requests are likely to impact schedules, use and maintenance requirements of other users of the Service Provider's infrastructure and for this reason the negotiation process should be limited to the Access Seeker and the Service Provider with the exception of the Service Provider having regard to existing contractual obligations to various other entities which can be done without the involvement of those entities. This will assist in making the negotiation process as efficient as possible which is in the best interests of customers who incur the costs of third party access processes and also the Access Seeker who presumably benefits from expeditious negotiations of their requests.
Part 5A – Confidential information	Section 33A(2)(e) creates unwarranted breadth and should be removed. Section 33A(5) should limit disclosure of confidential information to the regulator's rights and obligations under its founding act.

Part 6 – Division 1 Arbitration of access disputes	Part 6 Division 1 is appropriate in its entirety with the exception of the provisions for "other respondents" – refer comments in Part 5 above – the water industry is distinct from the rail industry and participation by parties other than the Access Seeker and the Service Provider will add cost without benefit to the process. In addition, the state-based access regime should provide for the following steps to occur in the negotiation process prior to referral to arbitration: 1. internal negotiation at officer level; 2. internal negotiation at senior management/Chief Executive level; 3. external private mediation (selected by agreement); and 4. referral to regulator for mediation (where referral to arbitration is the final step). These additional steps which are more reflective of negotiations in commercial conditions promote efficient processes and commercial outcomes – both of which have significant benefits for customers.
Division 2 – Conciliation and reference to arbitration	Section 36 appears applicable in its entirety. Section 37 should include a requirement that the appointed arbitrator be selected from a panel of arbitrators, agreed by the Access Seeker and the Service Provider jointly and/or evenly. The selection of arbitrator must be based on: 1. technical knowledge; 2. commercial expertise; and 3. utility industry knowledge/experience (with a preference for water industry knowledge/experience).
Division 3 – Principles of arbitration	Under section 38 an arbitrator is required to have regard to the "objects of this Act" in making a determination. This is only appropriate if there is sufficient emphasis on efficient use of water industry infrastructure for the benefit of the public in South Australia. It is inappropriate for access legislation to provide for competitive arrangements to arise by benefiting a small number of customers to the detriment of all others. The Department of Treasury and Finance should consider the impacts of inefficient competition and provide for this appropriately. Section 38(1) appears appropriate in its entirety; however, specific allowance should be made for the consideration of health, safety and environment impacts of the proposed access including providing for satisfactory compliance with the relevant standards. With regard to section 38(2) please refer to comments in section 5 of the main submission, Legislated Terms and Conditions. In essence SA Water is supportive of pricing principles that are consistent with clause 6(5)(b) of the Competition Principles Agreement. A state-based access regime would need to have specific regard to clause 6(5)(b)(i) – generate expected revenue for a regulated service.

Division 4 – Parties to arbitration	Section 39 is inappropriate to the extent that it allows participation by parties other than the Access Seeker and the Service Provider (refer to comments above). Other parties should participate to the extent that they provide relevant evidence for facts in question or questions of law. Sections 40 and 41 appear appropriate and should be retained.
Division 5 – Conduct of arbitration proceedings	The provisions under Division 5 are perhaps overly prescriptive however SA Water has no strong opinions on these sections. SA Water suggests the confidentiality requirements of an arbitrator be similar to those of the regulator under the *Essential Services Commission Act 2006*.
Division 6 – Early termination of arbitration	Division 6 is appropriate in its entirety.
Division 7 – Awards	Division 7 is appropriate in its entirety.
Division 8 – Withdrawal from award	Division 8 is appropriate in its entirety.
Division 9 – Variation or revocation of awards	Division 9 is appropriate in its entirety however section 55(5) should be reworded for clarity.
Division 10 – Miscellaneous	Division 10 is appropriate in its entirety.
Part 7 – Monitoring powers	Part 7 is appropriate in its entirety with the following exception: Section 61 appears appropriate except for the retrospective effect of the section. SA Water does not propose to provide a regulator with all retrospective agreements prior to the operation of state-wide access legislation on the basis that the administrative costs outweigh the monitoring benefits and in order to maintain the confidential information of the third parties who negotiated those agreements prior to the contemplation that the agreements could be released to any other party.
Part 8 – Enforcement of this Act	Part 8 is appropriate in its entirety.
Part 9 – Regulations and proclamations	Part 9 is appropriate in its entirety.

6.1.16 Are there other rights and/or obligations that should be included in the negotiation framework?

SA Water considers the IPART negotiation protocols (refer to Attachment 1) convey further rights and obligations on both service providers and access seekers that facilitate negotiations in good faith and efficiency in order to avoid escalating costs of third party access being incurred by either party and therefore their customers.

SA Water particularly supports the inclusion of provisions to allow for:

1. the application of negotiation protocols;
2. the stepped process at Table A (see Schedule 2 for further details, noting further suggestions above for suitability to the South Australian market);
3. clear information requirements (see Schedule 1 for further details, noting further suggestions above for suitability to the South Australian market);
4. a stepped dispute resolution process (refer above and Schedule 3);
5. clear requirements with regard to costs, good faith and other minor details that have been regulated by the IPART Negotiation Protocols creating a clear framework with very little room for misinterpretation or inefficient administration.

6.1.17 Does the Railways (Operations and Access) Act 1997 provide a good basis for a dispute resolution framework for a state-based access regime for water and sewerage infrastructure services?

Refer to table above.

6.1.18 Should a state-based access regime provide specific guidance to facilitate the development of new water and sewerage infrastructure?

A state-based third party access regime should not have to provide specific guidelines to assist the development of new water and sewerage infrastructure, as the *Water Industry Act 2012* already provides for private participation in water and wastewater service provision.

For developments that are not self sufficient SA Water provides information to interested parties, published on its website, regarding 'Extension Mains Land Development Agreements'. The purpose of these commercial agreements is to identify how an augmentation charge will be consistent, transparent and equitable. SA Water is to apply a State-wide infrastructure charge (SWIC)[26] plus an augmentation charge (AC)[27] where required. The SWIC will apply to the industry as of 1 July 2013.

These designs must comply with the national guidelines and codes as established by the Water Services Association of Australia (WSAA) in consultation with technical experts from the water industry around Australia. The purpose of the existing additional SA Water guidelines is to provide greater context as to what is experienced in South Australia as the national guidelines are broad in scope.

---

[26] The SWIC is a *'contribution to the impact on existing network that will be utilised to service the allotment which would include* all growth assets across the network'

[27] An AC is 'a contribution to recover the cost of upgrade works required to service the development area and is individually calculated for each development area.'

SA Water at present plays an auditing role in the process from the design phase to construction and installation of the infrastructure. However, the *Water Industry Act 2012* stipulates that a Technical Regulator must be appointed – the functions of Technical Regulator, amongst other roles, is 'to monitor and regulate technical standards with respect to water and sewerage installations and associated equipment, products and materials (including customers side of any connection point)'. It is anticipated that the function SA Water currently performs will transfer to the Office of Technical Regulator when all of the administrative arrangements have been made.

Arrangements in place to manage access in greenfield sites should focus on maintaining competitive neutrality between the service provider and access seekers. Clause 6 of the CPA requires access regimes to promote efficient investment in significant infrastructure, including in greenfields investments. A State-based access regime could provide for a binding non-coverage declaration for a period of time to apply to geenfields investments. Examples include the national gas access regime which contains the greenfields pipeline incentive - providing for an access holiday. Before a greenfields pipeline is commissioned, an infrastructure service provider may apply to the NCC for a 15-year no-coverage determination. If the application is approved, the pipeline will not be subject to access for 15 years after being commissioned. The New South Wales access regime similarly provides for greenfields investments to be subject to a binding non-coverage declaration for up to 10 years.

SA Water supports the proposed state-based access provisions for guidance to the arbitrator that the decisions of the arbitrator must not require the service provider/owner of the infrastructure to bear any of the costs associated with access related extensions of infrastructure. Infrastructure owners should have some certainty that they will earn adequate revenue from investment in new assets.

SA Water would also be supportive of provisions to be included in a state-based access regime for binding non-coverage declarations for new greenfields investment.

6.1.19 Are there other rights and/or obligations that should be included in relation to dispute resolution?

SA Water considers the model represented in Attachment 1 to be an efficient negotiation methodology implementing the required principle of good faith and various other efficiency measures. Third party access legislation for the South Australian water industry would benefit from provision of the following steps prior to referral to a regulator/arbitrator:

1. internal escalation; and

2. private mediation.

6.1.20 What terms and conditions of access, if any, should the state-based access regime regulate?

The following commentary is made in reference and/or in addition to the main submission (specifically sections 3 and 5).

6.1.20.1 Objects clause

It is common for access legislation to have an objects or objectives clause to outline the intent of the document. Some examples are provided below.

At a national level, the Commonwealth *Competition and Consumer Act 2010* (CCA) Part IIIA section 44AA:

> *"(a) promote the economically efficient operation of, use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets; and*
>
> *(b) provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry."*

At an industry level within South Australia, the *Natural Gas Pipelines Access Act 1995* provides an example of the objects clause in section 3:

> *"(a) to facilitate competitive markets in the gas industry;*
>
> *(b) to promote the efficient allocation of resources in the gas industry; and*
>
> *(c) to provide for access to pipelines on fair commercial terms and on a non-discriminatory basis."*

In specific regard to the water industry in New South Wales, Part 3 of the *Water Industry Competition Act 2006* provides a succinct objects clause:

> *"The object of this Part is to establish a scheme to promote the economically efficient use and operation of, and investment in, significant water industry infrastructure, thereby promoting effective competition in upstream or downstream markets."*

Section 1.2 of Sydney Water's Access Undertaking provides further objectives:

> *"(a) providing a framework to manage negotiations with Applicants for access to Water Network Services provided through the Water Supply Transport Network for purposes of the retail supply of drinking water in SWC's Areas of Operations;*
>
> *(b) establishing a workable, open, non-discriminatory and efficient process for lodging and processing Access Applications;*
>
> *(c) providing a non-discriminatory approach to pricing and the provision of Water Network Services;*
>
> *(d) operating consistently with the objectives and principles in Division 7 of Part 3 of the WICA and the Competition Principles Agreement;*
>
> *(e) reaching an appropriate balance between:*
>
> *(i) the legitimate business interests of SWC, including:*
>
> *(A) the recovery of all efficient costs associated with providing access to the Water Network Services;*
>
> *(B) a fair and reasonable return on SWC's investment in the Water Supply Transport Network commensurate with its commercial risk;*
>
> *(C) projects and measures to support the supply/demand balance for water that are funded through "postage stamp" water service and usage prices;*
>
> *(ii) the public interest, including the public interest in having competition in markets; and*

> *(iii) the interests of Applicants wanting access to the Water Network Services, including providing access:*
>
> *(A) on non-discriminatory price and non-price terms; and*
>
> *(B) in a transparent, open, efficient and non-discriminatory manner;*
>
> *(f) providing an efficient, effective and binding dispute resolution process in the event that SWC and the Applicant are unable to negotiate a mutually acceptable Access Agreement; and*
>
> *(g) consistency with any relevant pricing determinations for the supply of water including (where applicable) the maintenance of "postage stamp pricing".*

The Sydney Water example appears to contain the most comprehensive set of objectives, providing clarity for both access seekers and service providers. Section (a) to (d) and section (f) largely mirror the intent of the CCA provisions. Sections (e) and (g) provide clarity of the intent and there is merit in considering inclusion of similar clauses within the state-based access regime. These clauses would need to be amended to reflect South Australian Government policy intentions such as the services and customers within scope.

A review of the United Kingdom model does not highlight objectives within the individual companies's access codes, however companies are guided by OFWAT as to what to include in the access codes.

6.1.20.2 Eligibility criteria

Refer section 3.2 in the main submission.

6.1.20.3 Service provider of last resort

Prior to access occurring arrangements need to be made with respect to supplier and operator of of last resort (provider of last resort).

Where SA Water may be nominated as the provider of last resort SA Water should be able to ensure that the design and build of the network would meet minimum regulatory standards, in case an access seeker defaults on its obligations.

Two types of provider of last resort obligations exist:

- Operator of last resort – a situation where a service provider is required to operate third party infrastructure to provide third party water resources to third party customers; or
- Supplier of last resort – a situation where a service provider is required to source and supply water to third party customers (either through third party infrastructure or service provider owned infrastructure).

Division 6 of the *Water Industry Act 2012* provides operator of last resort powers to ESCOSA in the event that a retail licensee contravenes the Act or its licence ceases. Section 39(1) empowers ESCOSA to appoint an operator to take over the relevant operations on agreed terms and conditions (including remuneration and indemnities). This provision would provide the appointed operator the ability to negotiate potentially different service standards, arrangements for the operation of potentially inferior infrastructure, etc. These provisions are considered adequate.

However the *Water Industry Act 2012* is silent on supplier of last resort obligations. From a state-based access regime perspective, if there is no requirement for access seekers to ensure security of service and/or enable supplier of last resort arrangments for their customers, customers must be aware and accept that

condition. The state-based access regime should include provisions that the customer must accept the level of water security obligations offered by their supplier.

6.1.21 What information preparation requirements (e.g. pricing principles and accounting standards), if any, should the state-based access regime regulate?

The following commentary is made in reference and/or in addition to the main submission (specifically section 0).

6.1.21.1 Pricing

The Report suggests that some specific measures could be included within the state-based access regime to ensure sufficient information is available to the access seeker. The suggested measures relate to pricing of access and SA Water supports the view that pricing principles determined for the purposes of a state-based access regime should adopt the principles set out in clause 6(5)(b) of the CPA.

SA Water also considers that a state-based access regime should have mechanisms to ensure consistency of Government policy across retail and access pricing, specifically related to social policy issues (i.e. state-wide pricing and recovery of water security investment) to ensure that public and residential customers in particular are not disadvantaged as a result of the application of purist economic policy.

ESCOSA's retail pricing inquiries may result in reforms to retail pricing which may require adjustment to the proposed access pricing approach in the future. It is SA Water's view that access pricing principles should be complementary and consistent with the retail pricing policies. Future reform to access pricing should be made in line with retail pricing reforms to avoid unintended outcomes for residential customers and to avoid influence on ESCOSA's pending inquiries. This approach would ensure that the objective of encouraging efficient competition will not be undermined and the service providers and access seekers will be able to compete on equal grounds.

SA Water would support the initial adoption of access charges based on the existing retail charges and taking into account any costs that are incurred or avoided by the service provider, in any situation in which the customers supplied by an access seeker would otherwise be subject to regulated retail prices. This approach would ensure that the service providers and access seekers compete on equal grounds. A similar approach has been successfully demonstrated in Scotland where default retail tarriffs are set at the level Scottish Water (the monopoly infrastructure owner) would have charged if competition had not been introduced. This approach would provide an imperative safety net for all customers so that no customer is worse off as a result of competition.

The cost of service approach could be used in those cases in which retail prices did not apply. This could include, for example, the use of infrastructure to transport water to customers that would not otherwise have been supplied by the service provider.

As SA Water's retail service prices are informed by an allowable (efficient) annual revenue as determined by ESCOSA, it follows that resulting retail charges are based on efficient levels of costs. As this eliminates the risk of 'monopoly rents' in retail pricing retail prices are a sound and equitable basis for setting access prices.

A review of access arrangements in the water sector in other jurisdictions identifies a general trend towards access pricing being linked to retail pricing, as follows:

- ESC Vic recommended that in most cases access prices should be determined using a "retail minus" methodology28 ;

- United Kingdom Access Code Guidance requires appointed water companies in the United Kingdom to offer a discount from the standard retail tariff29 (retail minus); and

- New South Wales commenced with a retail minus access pricing arrangement under the Sydney Water declaration albeit has moved towards a cost of service approach in the NSW state-based access regime30. The more recent Sydney Water Access Undertaking moves a step further proposing a "cost-building block plus methodology"31 which effectively adds back the cost of water security to the costs of transport. However, the successful application of this approach is yet to be demonstrated.

6.1.21.2 Water security investment

Recovery of water security investment is a key issue that may warrant specific legislation to address some of the practicalities that will otherwise be left to SA Water and access seekers to sort out, making the process of access negotiation difficult and drawn out.

SA Water supports the current government policy where all customers contribute to the investment in water security through the inclusion of water security investment in state-wide retail prices.

This approach is also consistent with the broad principle included within the Sydney Water Access Undertaking which requires all customers, including access seekers, to fund water security investment. It should be noted that for Sydney Water this is mainly limited to recycling efforts and efficiency schemes.

6.1.21.3 Financial ring fencing

The extent of accounting ring fencing arrangements that may be required cannot be determined until the scope of access and application of pricing principles are established. Given potential business process and system changes that may be required lead times for implementation by water businesses will vary.

A key component of formulating SA Water's Regulatory Business Proposal (RBP 2013) was the ability, through the design and application of costing methodologies, to identify and allocate costs from its financial records pertaining to the regulated business only, across defined business segments. These costing methodologies together with associated outputs were independently reviewed and received external audit assurance.

This aspect is assumed to be consistent with Clause 6(4)(n) of the CPA as complying with 'separate accounting arrangements' at the level required by ESCOSA for SA Water's regulated business.

A further segregation may be required in order to allocate the regulated business costs and revenues by process (that will be defined by infrastructure access elements) using activity-based costing principles.

Following passing of the infrastructure access legislation, SA Water will require sufficient time and investment to ensure its financial data can be loaded and validated into an activity-based costing system in

[28] ESC Vic, *Inquiry into an Access Regime for Water and Sewerage Infrastructure Services—Final Report, Volume I: Findings and Recommendations*, September 2009, p. 1

[29] OFWAT, *Access Code Guidance*, September 2011, p. 7.

[30] NERA Economic Consulting, *Assessment of Third Party Access Arrangements in South Australia*, 5 January 2012, p. 33

[31] Sydney Water, *Water Network Access Undertaking Supporting Submission*, January 2012, p. iv

order to be able to generate costing data necessary to inform access pricing administration and reporting as may be required by the access regime.

Producing regulatory accounts is an annual process for which the first full year of reporting - in line with the regulatory period - is for the financial year ending June 2014. This timeframe may also impact on SA Water's ability to produce valid costing data for access purposes.

6.1.22 Are there any specific considerations that should be taken into account by the public health, environmental and safety standard regulators if there is a state-based access regime for water and sewerage infrastructure services?

Refer comments made in the main submission (section 5.6).

6.1.23 Is the requirement in section 90 of the Water Industry Act for the arbitrator to consult with public health, environmental and safety standard regulators sufficient?

Refer comments made in the main submission (section 5.6).

6.1.24 Are there other interstate issues in relation to the access regime for water and sewerage infrastructure services that need to be addressed?

Interstate reference is made in relevant parts of the main submission as well as the appendix where necessary.

6.1.25 What should be the period allowed for implementation of the state-based access regime by water industry entities and the regulator?

In recognition of the extensive scope of work to be undertaken in establishing the state-based access regime, an access regime for the South Australian water industry should be implemented in stages, including a period of monitoring before legislation is established and regulatory guidance is finalised. This approach would ensure that costs associated with implementation as well as unintended outcomes are minimised.

The timeframes should allow the water businesses time to understand obligations under the regime and to put the appropriate processes in place, including ring-fencing of financial information, preparation of standard access contracts and the suite of information that would be made available to access seekers. This would include any relevant system changes or addition of systems in order to satisfy the heightened information requirements and relevant timeframes.

The current timing for the introduction of a third party access Billcreates uncertainty for SA Water, with an access regime currently scheduled to precede conclusion of the retail pricing inquiries that ESCOSA is making. One possible solution is that the commencement of the access regime is coordinated to coincide with the implementation of any retail pricing reforms ESCOSA may suggest. This will ensure that neither potential access seekers nor water/wastewater retail customers are adversely affected as a result of unintended perverse outcomes.

Careful consideration of timing for the implementation of a legislated third party access regime is recommended taking into account the timing of ESCOSA's impending retail reform recommendations.

7 ATTACHMENT 1

7.1 IPART NEGOTIATION PROTOCOLS

Negotiation protocols

Water Industry Competition (Access to Infrastructure Services) Regulation 2007

D08/8482