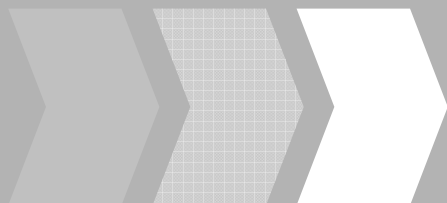


NATIONAL
COMPETITION
COUNCIL



The Lakes R Us application
for declaration
of water storage
and transport services



Final recommendation

10 November 2005

The National Competition Council

The National Competition Council was established on 6 November 1995 by the *Competition Policy Reform Act 1995* following agreement by the Australian Government and state and territory governments.

It is a federal statutory authority which functions as an independent advisory body for all governments on the implementation of the National Competition Policy reforms. The Council's aim is to 'improve the well being of all Australians through growth, innovation and rising productivity, and by promoting competition that is in the public interest'.

Information on the National Competition Council, its publications and its current work program can be found on the internet at www.ncc.gov.au or by contacting NCC Communications on (03) 9285 7474.

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1 Recommendation

- 1.1 On 8 October 2004 Lakes R Us Pty Ltd applied to the National Competition Council (the Council) for a recommendation that water storage and transport services provided by facilities operated by Snowy Hydro Limited and State Water Corporation be declared under part IIIA of the *Trade Practices Act 1974* (TPA). The Lakes R Us application covers two services defined in terms of use of each of the facilities of Snowy Hydro and State Water:¹
- (1) a water storage and transport service provided by Snowy Hydro using the Snowy Mountains Hydro-Electric Scheme (Snowy Scheme)
 - (2) a water storage and transport service provided by State Water using the Blowering Dam and Burrinjuck Dam facility.
- 1.2 Accepting that water in the Snowy System mostly moves by gravity along natural watercourses, the Council has considered the ‘water transport service’ as a ‘water release service’. The Council considers that describing a transport service as a release service does not alter the nature of the service to which Lakes R Us seeks access.
- 1.3 **The Council’s recommendation is that the water storage and release service of Snowy Hydro and the water storage and release service of State Water should not be declared under part IIIA of the TPA. The Council considers that the Lakes R Us application does not satisfy declaration criteria (a) and (f). That is, the Council is not satisfied that declaration would: promote competition in a dependent market; and not be contrary to the public interest.**
- 1.4 In making this recommendation the Council has taken account of information provided by specific parties and organisations, publicly available information and the submissions in response to its issues paper (released in April 2005) and its draft recommendation (released in September 2005) that the services not be declared. The two submissions received in response to the draft recommendation did not raise any new substantive issues or provide evidence or argument that the Council considers warrants a change to its draft

¹ The application (and supplementary submission) is available at www.ncc.gov.au.

recommendation. All 12 submissions received in response to the Lakes R Us application are listed on page 57.

2 The declaration criteria

2.1 Under part IIIA of the TPA, a business wanting access to a particular service can apply to the Council to have the service declared. The Council considers the application against the declaration criteria before forwarding a recommendation to the designated Minister² who decides whether or not to declare the service. Section 44K of the TPA provides for the applicant or service provider to apply to the Australian Competition Tribunal (the Tribunal) for review of the Minister's decision.

Box 1: The declaration criteria and section 44F(4) of the TPA

The Council cannot recommend that a service be declared unless it is satisfied that all criteria in s. 44G(2) of the TPA are met:

- (a) *that access (or increased access) to the service would promote competition in at least one market (whether or not in Australia), other than the market for the service*
- (b) *that it would be uneconomical for anyone to develop another facility to provide the service*
- (c) *that the facility is of national significance, having regard to*
 - (i) *the size of the facility or*
 - (ii) *the importance of the facility to constitutional trade or commerce or*
 - (iii) *the importance of the facility to the national economy*
- (d) *that access to the service can be provided without undue risk to human health or safety*
- (e) *that access to the service is not already the subject of an effective access regime and*
- (f) *that access (or increased access) to the service would not be contrary to the public interest.*

The Council must also consider, in the case of services provided by multiple facilities, whether it would be economical for anyone to develop another facility that could provide part of the service (s. 44F(4))—see appendix A.

Note: The Council begins its assessment of the declaration criteria by considering criterion (b) because this criterion focuses on whether the relevant facility has natural monopoly characteristics, conferring market power on its owner.

² In this matter, the Hon. Morris Iemma, MP. Premier of New South Wales.

3 The Lakes R Us application

- 3.1 Lakes R Us is a venture company that has been set up specifically to manage unused water allocations in the Murray and Murrumbidgee irrigation systems.
- 3.2 On 3 May 2004 Lakes R Us requested that Snowy Hydro provide it with access to the water storage and transport services provided by Snowy Hydro's Snowy Scheme facility. Snowy Hydro declined the request by stating that it is unable to enter into any agreement with any third party in relation to capacity in its water storages.
- 3.3 On 8 October 2004 Lakes R Us applied to have the water storage and transport services³ provided by facilities operated by Snowy Hydro and State Water declared under part IIIA of the TPA. On 12 January 2005 Lakes R Us provided supplementary material to the Council to complete its application.
- 3.4 Lakes R Us proposes to store up to 800 000 megalitres of water sourced from savings (unused allocated water) made by downstream entitlement holders using the excess storage capacity (vacant air space) of the Snowy Scheme facility operated by Snowy Hydro. It proposes to release the stored water on demand to users in the Murray and Murrumbidgee irrigation areas; to provide a water loan service; or to be traded (including for use in electricity production). Lakes R Us proposes to use the water release services provided by facilities operated by Snowy Hydro and State Water to transport the water to its customers.
- 3.5 Lakes R Us proposes to transfer the 'saved' water into the Snowy Hydro storages by 'swapping' it with water that would otherwise be released by Snowy Hydro as part of its water release activities in the following water year. The proposal would require amendment of New South Wales's water management arrangements to permit New South Wales entitlement holders to store water beyond the year of allocation and in excess of current carryover provisions.

³ Hereafter 'water storage and transport services' are referred to as water storage and release services (see paragraphs 4.3–4.7 for details).

- 3.6 Lakes R Us seeks access to the excess capacity of the Snowy Hydro storages for up to 30 years.
- 3.7 Lakes R Us considers that its proposal is similar to, and would be a competitor for, the ‘Snowy borrow’ provided by Snowy Hydro. In some circumstances Snowy Hydro is able to negotiate with downstream water users on the timing of its ‘above target’ water releases so that the users can obtain (borrow) water additional to their allocation. Because of the water licensing arrangements in New South Wales Snowy Hydro may make Snowy borrow water available only to general security (low priority) water licence holders. Borrowed water must be repaid from a user’s next water allocation (although the debt may be rolled over in some circumstances).
- 3.8 Lakes R Us considers that its proposal will enable Murray and Murrumbidgee irrigators to store their unused annual water allocations in the Snowy Hydro facilities for use in subsequent years allowing irrigators to better plan their operations leading to productivity growth and increased competition. For example, Lakes R Us considers that production guarantees for the supply of commodities produced from agriculture requiring the certainty of irrigation water will be more readily entered into and that this, in turn, will increase competition in the supply of these commodities in Australia and internationally.
- 3.9 Lakes R Us is seeking the following terms and terms and conditions of access:
- a maximum charge of \$1 a megalitre a year for using the vacant airspace in Lake Eucumbene
 - first priority access to water storage capacity that is in excess of Snowy Hydro’s requirements to enable storage of up to 800 000 megalitres of water
- Lakes R Us accepts that if the total storage space available to Snowy Hydro becomes full and a spill occurs, subject to advance notice, the volume of water that spills would be deducted from the water it has stored with Snowy Hydro.
- 3.10 If the services covered by the Lakes R Us application are declared then all third parties acquire a legal right to negotiate access to the services. The Council does not consider the terms and conditions of access.

4 The services, the facilities and the service providers

- 4.1 In considering an application for declaration of a service it is necessary to define the service(s) subject to declaration, determine the facilities used to provide the service(s) and identify the service provider(s) that owns or operates the facilities.

The services sought to be declared

- 4.2 The declaration process provides for access to the services provided by a facility (or part of a facility), rather than the facility itself. Section 44B of the TPA states that a ‘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*
- (e) *the use of intellectual property*
- (f) *the use of a production process*

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

- 4.3 The relevant service is the thing that is bought and sold, or for which there are potential transactions (Duke EGP decision (May 2001), para 68). Each water storage service is necessarily in a particular storage facility, each water transport/release service is necessarily from a specified facility into a specified waterway. Together, the services comprise the commercial service that would be provided by a water storage and transport/release service operator to its customers.

- 4.4 Lakes R Us states that it seeks access to a ‘water storage and transport service’ from the storage facilities in the Snowy Scheme to exit points that would allow specified volumes of water to be released into the Murray and Murrumbidgee rivers where the water can be extracted by water users. Lakes R Us is seeking declaration of a

‘water storage and transport service’ provided using facilities operated by Snowy Hydro and State Water.

- 4.5 State Water argues that it does not provide water transport services. Rather it considers that it provides a water release service. It releases water from its storage facilities into the river systems in accord with the requirements of the New South Wales *Water Management Act 2000* and relevant water sharing plans. The water released flows along natural waterways transported by gravity. The rate at which the water flows is affected by State Water’s release patterns, natural inflows of water and extraction rates. State Water asserts that reference to its ‘transport service’ and any underlying premises is therefore inconsistent with law and policy (State Water, sub 2, p. 4).
- 4.6 State Water considers that it is not clear that a feature of the natural landscape such as a river system can be a facility for the purposes of s44B of the TPA. It considers therefore that it follows that the TPA does not provide for access to a water transport service along a natural waterway.
- 4.7 The Council accepts that a water transport service may not be an accurate descriptor in the rural water industry in circumstances where water moves by gravity. Consequently, in considering this application, the Council is adopting the term ‘water release service’ instead of ‘water transport service’. The Council considers that use of the term ‘release’ in place of ‘transport’ does not alter the nature of the service to which Lakes R Us seeks access since water released from a water storage facility envisages the transport of water along waterways (natural or otherwise) to the points where users are able to extract the water. Similarly, Snowy Hydro’s use of pumps to transport water between storages (activity that might be described as water diversion) is also generally consistent with the concept of water transport/release that underlies the Lakes R Us application.
- 4.8 The Council considers that declaration need not apply to the natural waterways, as use of the man-made water storage and release assets is sufficient to enable the water storage and release service to be provided.
- 4.9 It follows that Lakes R Us seeks a ‘water storage and release service’ provided by Snowy Hydro that consists of:
- a water storage service provided by the vacant air space of the Snowy Scheme water storages—Lake Eucumbene, Lake

Jindabyne, Talbingo Reservoir, Tantangara Reservoir and Jounama Pondage

- a water release service provided by a series of tunnels and channels in the Snowy Scheme to allow water to flow from the scheme to Blowering and Burrinjuck dams or to an exit point in the Murray River upstream of Hume Dam
- a water release service through (the adjunct) Blowering Power Station
- a connection service provided via valves, switch gear and all related equipment and systems for the storage and release of water from the facility.

4.10 Lakes R Us also seeks a ‘water storage and release service’ provided by State Water that consists of:

- a temporary water storage service in Blowering and Burrinjuck dams to accommodate water released by Snowy Hydro on behalf of Lakes R Us
- a water release mechanism at Blowering Dam that allows water to flow along the watercourse to exit points in the Murrumbidgee River where the water can be extracted by water users
- a connection service provided via valves, switch gear and all related equipment and systems to permit the release of water from the facilities.

4.11 The Council considers that Lakes R Us is seeking a single bundled service of water storage and release provided by the facilities of both Snowy Hydro and State Water. There would be little sense in unbundling the component services because water storage would have little or no value without the ability to access the water via a release service. Moreover, any third party seeking access to the water storage and release service provided by Snowy Hydro would likely seek flexibility to release water to both the Murrumbidgee and the Murray rivers such that distinguishing geographically between the service to each river system is not necessary. The Council is not aware of any cost differences between the services to the two river systems that would cause a user to seek to differentiate between its use of the systems.

4.12 Because the single bundled service is provided by two entities, the Lakes R Us matter involves two applications—one for the water

storage and release service provided by Snowy Hydro and one for the water storage and release service provided by State Water.

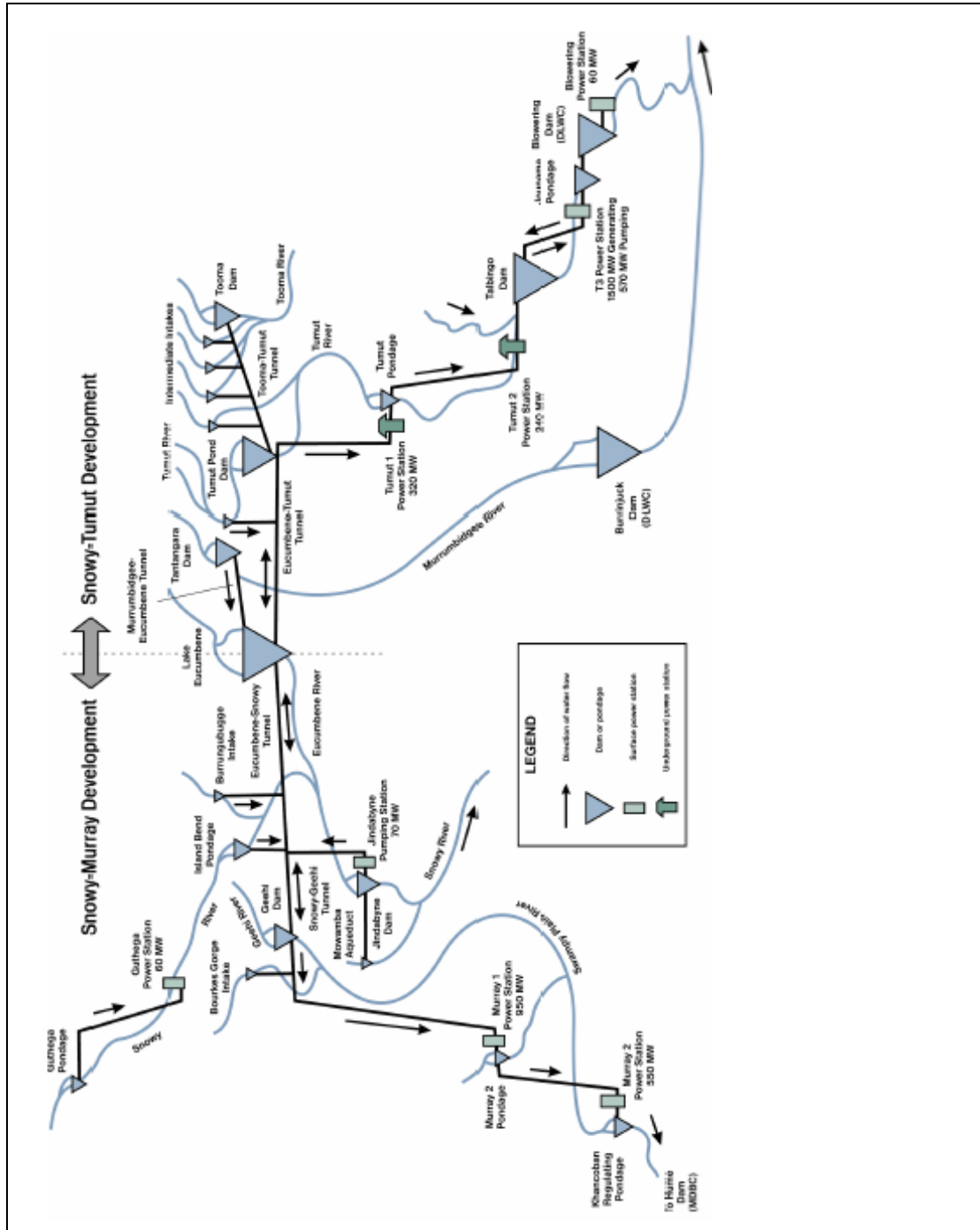
Facilities providing the services

- 4.13 The declaration criteria and the definition of service in s44B refer to the facility that provides a service. The TPA does not define the term ‘facility’, although it cites examples, including roads and railway lines and the handling or transporting of things such as goods or people. In the Sydney Airport decision, the tribunal said that ‘a facility for the purposes of the Act is a physical asset (or set of assets) essential for service provision’ (para 82). The relevant facility is therefore comprised of ‘the minimum bundle of assets required to provide the relevant service subject to declaration’ (para 192).
- 4.14 Lakes R Us states that it requires use of the entire Snowy Scheme⁴ and integrated (State Water operated) dams (see figure 1). It identified these assets as including the major storage facilities: Guthega Pondage, Bourkes Gorge Intake, Khancoban Regulating Pondage, Geehi Dam, Jindabyne Dam, Island Bend Pondage, Burrungubugge Intake, Lake Eucumbene, Tantangara Dam, Tumut Pond Dam, Tooma Dam, Tumut Pondage, Talbingo Dam and Jounama Pondage, Blowering Dam and Burrinjuck Dam. The assets also include water transport and release facilities (the Eucumbene–Snowy Tunnel, Snowy–Geehi Tunnel, Eucumbene–Tumut Tunnel, Murrumbidgee–Eucumbene Tunnel) and connection facilities such as valves, switch gear and all related equipment and systems necessary to provide the water storage and release service, including water release services through Blowering Power Station.
- 4.15 In responding to the issues paper Lakes R Us clarified that it requires use of both Blowering and Burrinjuck dams given that State Water integrates its use of these facilities to deliver water to users in the Murrumbidgee irrigation area. State Water also uses other water regulating equipment to provide water storage and release services. Lakes R Us has not specifically identified such equipment, but has described its requirement as the ‘use of all necessary connection assets and equipment necessary for the provision of the water storage and transport service’.

⁴ The Snowy Scheme comprises the works owned and operated by Snowy Hydro in the Snowy Mountains region.

4.16 As can be seen from figure 1, Hume Dam is part of the water regulation system for the Murray River. Lakes R Us has not sought declaration of the water storage and release service of the Hume Dam facility.

Figure 1: Diagrammatical layout of the Snowy Scheme and integrated (State Water operated) dams



Source: DITR (Department of Industry Tourism and Resources) 2000, part A, p. 38.

- 4.17 Lakes R Us believes that New South Wales temporary water trading rules would allow water released from the Snowy Scheme for third parties to be delivered to customers along the Murray River. Lakes R Us has not explained why these rules would apply in the case of water storage and release from Hume Dam and not to water storage and release from Blowering and Burrinjuck dams.
- 4.18 Figure 1 indicates that in parts of the scheme water can be diverted along both man-made and natural waterways. The parts of the scheme used to divert water are determined by commercial and environmental considerations. The volume, direction and rate and flow of the water through all parts of the scheme (including natural waterways) are regulated using the physical assets of the scheme in combination with gravity. Although natural waterways are involved, the use of the physical man-made assets is the key to providing the water storage and release service. Consequently, it is these assets that make up the minimum bundle of assets capable of providing the water storage and release service. The Snowy Scheme and the integrated State Water operated dams—Blowering and Burrinjuck—can be considered to comprise this suite of assets.
- 4.19 In the issues paper the Council sought views on whether the Blowering Power Station facility forms part of the minimum bundle of assets required to provide the water storage and release service. State Water commented that:
- The ownership of Blowering Power Station was vested in Snowy Hydro Ltd in the corporatisation process. However, it is located on State Water land and Snowy Hydro meets rental costs.*
- Blowering Power Station's operation is coordinated with State Water's releases to meet downstream needs. Total releases, as determined by State Water, can be a combination of releases through the power station and irrigation valves, with the power station having priority. Snowy Hydro receives the generation revenue from the power station. (State Water, sub 1, pp. 25–6)*
- 4.20 The Council is of the view that Blowering Power Station does not form part of the minimum bundle of assets necessary to provide the water storage and release service. While this asset is owned and controlled by Snowy Hydro, the power station does not hinder or promote the release of water into the Murrumbidgee River. It is therefore not necessary for provision of the water storage and release service.

- 4.21 The Council considers therefore that the minimum necessary bundle of Snowy Hydro assets is the entire Snowy Scheme, excluding Blowering Power Station (the specific assets that form the Snowy Scheme are listed at paragraph 4.14). The Council considers that the minimum necessary bundle of State Water assets is Blowering and Burrinjuck dams and all related water regulating or connection equipment necessary to enable third parties to deliver water released from Blowering and Burrinjuck dams into the Murrumbidgee River to their customers in the Murrumbidgee irrigation area.
- 4.22 All identified facilities are located in southern New South Wales. The identified Snowy Hydro facility—the Snowy Scheme—and the State Water facilities form the interconnected and integrated regulated water supply system for the Murray and Murrumbidgee rivers. The facilities identified are also used by Snowy Hydro for power generation.

Providers of the facilities

- 4.23 Snowy Hydro owns and operates the Snowy Scheme. It is the provider of the water storage and release service of this facility. Snowy Hydro is a corporation jointly owned by the Australian (13 per cent), New South Wales (58 per cent) and Victorian (29 per cent) governments. It operates the Snowy Scheme in accord with the Snowy Water Licence issued under part 5 of the Snowy Hydro Corporation Act. Its operations comprise the generation and marketing of flexible and renewable electrical energy, ancillary services and related electricity products, and the storage and diversion of bulk water to the Murray and Murrumbidgee rivers (Snowy Hydro Limited 2004, p. 3).
- 4.24 State Water operates and manages Blowering and Burrinjuck dams on behalf of the Government of New South Wales. It is the provider of the water storage and release service at Blowering and Burrinjuck dams. State Water is a New South Wales Government owned corporation established under the *State Water Corporation Act 2004* and the *State Owned Corporations Act 1989*. State Water commenced business on 1 July 2004 and operates under the Initial Operating Licence, which has been issued for a period of three years.
- 4.25 State Water incorporates into a single business all of the State's bulk water delivery functions outside of the areas of operation of the Sydney Catchment Authority, Sydney Water Corporation, Hunter

Water Corporation and other water supply authorities. State Water provides water to irrigation corporations, country town water supply authorities, farms, mines and electricity generators, by releasing flows from its dams and using natural streams as conduits. It is also responsible for delivering environmental flows in regulated rivers. All functions must be provided in accord with the State Water Corporation Act and associated licence.

Conclusions

4.26 The Council considers that the Lakes R Us application comprises two separate but related applications and that it is appropriate to adopt the following definitions for assessing the application against the declaration criteria.

(a) The water storage and release service provided by Snowy Hydro:

(i) The Snowy Scheme is the relevant facility that provides the water storage and release service. This facility does not include Blowering Power Station, which operates as an adjunct to the scheme.

(ii) Snowy Hydro is the provider of the water storage and release service. It owns and operates the Snowy Scheme facility (the New South Wales Government owns 58 per cent of Snowy Hydro).

(b) The water storage and release service provided by State Water:

(i) Blowering and Burrinjuck dams and all related water regulating equipment operated by State Water in the Murrumbidgee River form the minimum bundle of assets making up the relevant facility used to provide the water storage and release service. Hereafter this facility is referred to as the Blowering and Burrinjuck facility.

(ii) State Water is the provider of the water storage and release service. It operates the Blowering and Burrinjuck facility (the New South Wales Government wholly owns State Water).

- 4.27 The Council considers that the Hon. Morris Iemma, MP, Premier of New South Wales, is the decision maker for the purposes of the Lakes R Us application for declaration of the water storage and release services provided by Snowy Hydro and State Water because the New South Wales Government is the majority shareholder of both entities (s44D(2) of the TPA).

Are the services covered by part IIIA?

- 4.28 Part IIIA defines a service that can be declared as excluding services that use a production process except to the extent that it is an integral but subsidiary part of the service (s44B).
- 4.29 Snowy Hydro has advised the Council that it stores and transports water through the Snowy Scheme to maximise the volume of water inflows so that it has sufficient water to produce hydroelectricity and electricity risk management services for the National Electricity Market (NEM). Snowy Hydro considers therefore that the services that it provides that are the subject of the declaration application are part of a production process (Snowy Hydro Limited 2005).
- 4.30 State Water has not raised this matter in relation to its services.

Definition of a production process

- 4.31 In *Hamersley Iron Pty Ltd v National Competition Council [1999] FCA 867* the Federal Court of Australia defined a production process as ‘a series of operations by which a marketable commodity is created or manufactured’.
- 4.32 The wording of the Hamersley decision indicates that a production process:
- (a) is a ‘series of operations’, that is, a *process*
 - (b) involves the creation or manufacture of a commodity, that is, *production*
 - (c) ends once a commodity exists that is capable of being sold.
- 4.33 In the Hamersley decision, the relevant production process was found to extend from the commencement of mining operations to the completion of a product for sale, namely, an export product. The use

of ‘marketable’ rather than ‘marketed’ indicates that the relevant test is whether a commodity is capable of being the subject of market transactions, rather than whether such transactions currently exist. (Clearly, where a product is, or has been the subject of market transactions, it is marketable.)

- 4.34 The Council considers that there are difficulties associated with the precedent established by the *Hamersley* decision and notes that the interpretation of s44B will be further considered in proceedings currently before the Federal Court. Nevertheless the *Hamersley* decision represents the current law and therefore provides the test that the Council must apply in considering the Lakes R Us matter.

Snowy Hydro’s operations

- 4.35 Snowy Hydro’s operations broadly involve the following basic steps:
- (a) collection of water
 - (b) storage of water
 - (c) release of water
 - (d) generation of hydroelectricity.
- 4.36 Snowy Hydro (sub 12) argues that, with the exception of some environmental flows and evaporation, all water collected and stored in the Snowy Scheme is used for the production of electricity. Accordingly, it considers that its operations constitute a production process for electricity (Snowy Hydro, sub 12). Lakes R Us also acknowledges that most of the Snowy Hydro storage is used to store water for electricity production.
- 4.37 The Council accepts that Snowy Hydro collects, stores and releases water to generate electricity. It does not necessarily follow that these steps are part of a production process for the purposes of part IIIA, however. As already noted, the *Hamersley* decision provides that a production process ends at the point at which a marketable commodity is produced. A marketable commodity—water—exists at the point of collection and storage. The New South Wales Government and other jurisdictions sell this water in the form of an entitlement to extract water under licence.
- 4.38 The water collected from the Snowy Catchment is not treated in any way prior to its release downstream, indicating that the water in the

catchment is of sufficient quality to be capable of being marketable for irrigation or similar purposes (including for purposes that require subsequent treatment). Thus water (specified as a right to extract water) is capable of being the subject of market transactions prior to it entering the Snowy Hydro facility.

- 4.39 In this case it is not relevant that Snowy Hydro—the facility owner—is not producing the merchantable product. Rather this reflects that there is commercial separation between the ownership of the water and the facility. The New South Government granted a right to Snowy Hydro to use the water for electricity production and also use the facility (via licensing obligations imposed on Snowy Hydro) to store and release water so that the water can be sold for extractive and other purposes downstream.
- 4.40 Moreover, while Lakes R Us (and other third parties) may not have the ability to direct the water through the turbines of the scheme or via alternative waterways that do not involve electricity generation, it is indifferent as to the pathway including whether the turbines are present or operating, except to the extent that electricity production affects the cost and quality of service. Accordingly, there is an argument that the facility that constitutes the minimum bundle of assets required to provide the service, that is the water storage and release equipment, does not include the turbines used to produce electricity.
- 4.41 In addition, Lakes R Us argues that Snowy Hydro’s electricity risk management products are merchantable prior to Snowy Hydro’s use of the facility. It states that Snowy Hydro’s electricity risk management products (which are sold at up to five years in advance of the risk product being required) are capable of being the subject of market transactions. It further states that because ‘other institutions deal and profit, in electricity risk management products and have no means of electricity generation at all ... generation of electricity is not essential to this commodity’ (p. 8).
- 4.42 The Council considers that these arguments have no bearing. The timing of the transaction for the sale of a product or service is not relevant to the technical nature of how the product or service is created. Consistent with the Hamersley decision, which is concerned only with products that involve the physical use of the facility in question, the Council has not considered pure financial electricity risk management products. Such products, while concerned with electricity, and potentially how a particular facility is managed, do not directly involve use of the facility.

Conclusion

- 4.43 The Council considers that the water storage and release service of the Snowy Scheme is a service that is consistent with the definition of ‘service’ in part IIIA. The Council’s view is that the ‘production process’ exception at s44B does not apply, and that it has jurisdiction to consider the Lakes R Us application.

5 Criterion (b): The uneconomical to develop another facility test

- 5.1 In considering any declaration application, the Council begins its assessment by considering criterion (b). Conceptually, it is logical to commence with this criterion because it focuses on the service to which access is sought and the facility providing that service, and asks whether the facility has natural monopoly characteristics.
- 5.2 Criterion (b) requires the Council to consider whether it would be uneconomical to develop another facility to provide the service to which access is sought. A facility is uneconomical to develop if, for the likely range of reasonably foreseeable demand for the service it provides, it would be more efficient, in terms of costs and benefits to society as a whole, for the single facility to provide the service rather than two or more facilities.

Snowy Hydro

- 5.3 Earlier the Council explained that it considers, for the purposes of the Lakes R Us application for declaration, that the Snowy Scheme is the relevant facility owned and operated by Snowy Hydro. Accordingly, the Council must determine whether the Snowy Scheme is able to satisfy the reasonably foreseeable demand for the water storage and release service at lower cost than two or more facilities.
- 5.4 Lakes R Us states that there is no facility other than the Snowy Scheme that can economically and efficiently deliver water into both the Murray and Murrumbidgee river systems. Moreover, Lakes R Us argues that because the Snowy Scheme captures all the available water in the Snowy catchment it would not be viable to build an alternative storage facility in the area. Lakes R Us considers that the

Snowy Scheme facility is underused and that governments would not approve construction of an alternative storage facility in Kosciusko National Park. Lakes R Us further considers that it would not be viable to build a pipeline to transport water as an alternative to using the natural waterways because the financial cost would be too high and there are possible adverse environmental consequences.

5.5 Lakes R Us considers that there are no alternative high quality water storage facilities available that have the capacity to divert large volumes of water into the Murray and Murrumbidgee river systems. Lakes R Us notes that evaporation rates in the Snowy Hydro storage facilities are lower than for other dams in the area. Lakes R Us considers that farm dams do not provide viable alternatives to the Snowy Scheme because farm dams are expensive to build and may displace usable farmland resulting potentially in lower output. Moreover, Lakes R Us states there is no available mechanism for trading or transferring water originating from farm water storage.

5.6 Few submissions commented on criterion (b). Murray Irrigation Limited states that 'it would be uneconomical, illogical and technically impossible to establish another facility which has the harvesting and storage capacity and low evaporation benefits of the Snowy Scheme to store unused carryover water' (MIL, sub 4, p. 10). However, the Ricegrowers' Association of Australia (RGA) stated that:

The only distinct advantage of using the Snowy Hydro facilities is reduced losses but without modelling to ascertain the difference between Snowy Hydro storage facilities and those of Hume and Blowering Dams and perhaps further facilities downstream (yet to be constructed), there is no real data to determine the extent. (RGA, sub 5, p. 7)

RGA disagrees with the views of [Lakes R Us] regarding farm dams. In this age of water use efficiency, there is scope to improve on farm water use efficiency greatly and RGA sees this area as that which provides irrigators with the most scope for improvement. This is a critical component of Land and Water Management Plans and the Australian rice industry's Environmental Champions Program. The components which can be addressed include irrigation layouts, laser levelling, and recycle systems on farms including storage dams.

At this stage, the current water sharing arrangements, combine[d] with improvement[s] [to] on farm irrigation systems will provide most irrigators with the flexibility required to

manage their irrigation businesses, including water trading and carry over facilities. (RGA, sub 5, p. 7)

- 5.7 In a submission prior to the release of the issues paper Snowy Hydro also contended that:
- alternative facilities exist, or could be developed, that can economically and efficiently deliver water into the Murray and Murrumbidgee river systems
 - existing water trading schemes provide irrigators with the same ability to increase the yield of their current water allocations as the Lakes R Us proposal.
- 5.8 In responding to the draft recommendation Snowy Hydro reiterates its view that criterion (b) is not met. Snowy Hydro notes that there is existing infrastructure at Dartmouth and Hume, for example, and that the Department of Infrastructure, Planning and Natural Resources (DIPNR)⁵ has identified potential sites for enroute storages on the Murrumbidgee River (Snowy Hydro, sub 12).
- 5.9 Most enroute water storage facilities downstream of the Snowy Scheme, including Dartmouth and Hume dams are suitable for short term storage only. Thus the water storage and release services provided by the existing facilities or potential new facilities are not equivalent to the service being sought in the Lakes R Us application or likely to be sought by other third parties.
- 5.10 Moreover, while it may be technically feasible to store 800 000 megalitres of water (the capacity sought by Lakes R Us) in, say, Hume and Blowering dams, consideration of alternative facilities further downstream is not consistent with the tribunal's point-to-point approach. Further in the Sydney Airport decision the tribunal said that 'a facility for the purposes of the [TPA] is a physical asset (or set of assets) essential for service provision' (para 82). For the purposes of criterion (b) therefore this would preclude water deals and other financial arrangements in determining whether it is uneconomic to develop another facility.
- 5.11 It would be costly to build new facilities to provide the relevant services. The Snowy Scheme is a significant engineering structure,

⁵ DIPNR is now two departments: Department of Planning and the Department of Natural Resources.

which took around 25 years to build. Whelan (1997) reported that the cost of constructing the scheme today would likely exceed \$6 billion.

- 5.12 In terms of current and foreseeable demand State Water notes that the demand for extractive water and environmental flow are not fixed. Rather demand varies from season to season depending on climate and water availability. The availability of water is, however, subject to a range of regulatory constraints, including the New South Wales embargoes on the issuing of new licences in the Murrumbidgee and Murray valleys and the Murray Darling Basin Council's cap, which limits diversion in each valley to the volume of water equivalent to that which would have been diverted under 1993-94 levels of development.
- 5.13 The key constraining factor in this case is not demand, but the supply of extractive water and the need to meet environmental requirements. Snowy Hydro captures and diverts all available water in the Snowy Mountains catchment. The issue therefore turns on whether there is capacity in the Snowy Scheme to provide the service sought by Lakes R Us. Currently the reservoirs of Lake Eucumbene and Lake Jindabyne at around 50 per cent capacity and data indicate that storages have rarely been more than two-thirds full. This would suggest there is sufficient spare capacity to accommodate access to the water storage and release service. However, the Lakes R Us proposal may involve some alteration to historic release patterns. This may reduce the level of spare capacity in the future.

State Water

- 5.14 Earlier the Council explained that it considers, for the purposes of the Lakes R Us application, that the Blowering and Burrinjuck dams facility is the relevant facility operated by State Water for the purposes of the Lakes R Us application for declaration. Accordingly, the Council must determine whether the Blowering and Burrinjuck dams facility is able to satisfy the reasonably foreseeable demand for the water storage and release service at lower cost than two or more facilities.
- 5.15 The Blowering and Burrinjuck dams are highly integrated with the Snowy Scheme and are critical to the managing water supplies for irrigators, other water users and the environment in the Murrumbidgee River. Consequently, just as for the Snowy Scheme, the Council considers the current and foreseeable demand for water.

- 5.16 Capacity would not appear to be a significant issue given that the facility is designed and managed in a way that caters for considerable variation in hydrological conditions. However, constraints, including storage and channel capacity and environmental requirements may limit when and how the facility could be used to provide the water storage and release service.

Conclusion

- 5.17 In respect of the Lakes R Us application for declaration of the Snowy Hydro facility, the Council considers that criterion (b) is satisfied because it would be uneconomical for anyone to develop another facility to provide the water storage and release service provided by the Snowy Scheme.
- 5.18 The Council considers that the Blowering and Burrinjuck dams facility also satisfies criterion (b) because of the high degree of interconnection between the Blowering and Burrinjuck dams facility and the Snowy Scheme.

6 Criterion (a): The promotion of competition test

- 6.1 Criterion (a) is intended to ensure that access is granted only where there will be competition benefits in markets beyond the market for the service to which access is sought. The issue is whether access would improve the opportunities and environment for competition such that competitive outcomes are more likely. The assessment is concerned with the process of competition rather than the particular commercial interests or pursuits of individual competitors.
- 6.2 As noted at paragraph 3.2, in 2004 Snowy Hydro declined a request from Lake R Us for third party access to the services of the Snowy Scheme facility. Evidence of an exercise of market power, through a denial of access to a bottleneck service, would generally satisfy the test under criterion (a). In New South Wales, however, the right to the control, use and flow of water is vested in the Crown (Water Management Act, s392) and only Snowy Hydro may access water collected in the Snowy Scheme. Snowy Hydro is subject to a range of statutory obligations in relation to electricity generation, water

releases and the environment. Criminal sanctions potentially apply to the directors and officers of the Snowy Hydro for breach of the obligations. Snowy Hydro argues that, given these conditions, it is prevented from agreeing to third party access to its services.

6.3 The purpose of part IIIA of the TPA is to investigate whether declaration, by promoting competition, would provide a net benefit to Australia. If declaration were warranted because it would provide an overall benefit, then there would be an argument for amending the regulatory environment to enable the activity that depends upon third party access to occur. The Council is therefore considering whether the water storage and release services that are the subject of the declaration application satisfy criterion (a).

6.4 This involves assessing whether the incumbent service providers have an ability or incentive to use market power to adversely affect competition in a dependent market(s). Where a service provider, in the absence of access regulation, is able to adversely affect competition in a dependent market, then regulated access may improve the environment for competition. The Council's approach to considering criterion (a) is to:

- (a) define the relevant market(s) in which competition may be promoted and verify that the market(s) are separate from the market for the service to which access is sought
- (b) determine if access (or increased access) would promote a more competitive environment in the additional market(s). This requires an assessment of:
 - (i) whether the incumbent has the ability and incentive to exercise market power to adversely affect competition in the dependent market(s)
 - (ii) whether the structure of the dependent market(s) is such that declaration would, by constraining the exercise of market power by the service provider, promote competition.

The institutional environment: will access mean competitive outcomes are more likely

6.5 Water management arrangements in New South Wales are established by the Water Management Act and associated water

sharing plans. In the case of the Lakes R Us application, the relevant water sharing plans are the Murrumbidgee Regulated River Water Sources, Murray and Lower Darling Regulated River Water Sources and the Lowbidgee and other Unregulated Stream Water Sharing Plan.

- 6.6 Under the Act, the right to the control, use and flow of this water is vested in the Crown (Water Management Act, s392). Under the water sharing plans, licensed water users in the Murray and Murrumbidgee river systems have an entitlement to extract water (on a priority basis) downstream from the Snowy Scheme with a right to carry a limited volume of (unused) allocated water over from one year to the next (carryover rights are not available in Victoria and South Australia). Carryover provides licence holders with an opportunity to choose to adjust their own supply reliability by forgoing water in the current year to boost supply reliability in future years. Carryover is only available for general security water licences in the Murray and Murrumbidgee river systems because reliability of supply is less assured for this category of licence than for high security water licences.
- 6.7 Snowy Hydro states that because water users downstream of the Snowy Scheme do not have extractive rights to the water collected in the Snowy Hydro storages third parties would be unable to use its water storage and release service even if the service is declared. Snowy Hydro therefore considers that access would not promote competition in any market (Snowy Hydro Limited 2005). State Water advises that the Murray and Murrumbidgee water sharing plans do not cover the water in Snowy Hydro's area of operations and that water entitlements managed within the mandatory framework of the two plans cannot be dealt with or transferred, notionally or actually, into an area in which the plans do not operate.
- 6.8 Lakes R Us notes that the current regulatory structure within the Murray–Darling Basin was negotiated without consideration to the storing of unused allocated water in the Snowy Hydro storages. It considers this to be an oversight (Lakes R Us, sub 11). Lakes R Us notes, however, that current water trading arrangements permit the transfer of water between water planning areas. Moreover, the Snowy Scheme is sometimes used to redirect flows between the Murray and Murrumbidgee river systems to meet water trading requirements. Managing water in this way does not however alter the annual volume of releases from the Snowy Scheme.

- 6.9 The changes required to effect declaration appear to go well beyond the removal of regulatory impediments to competition. The Council's view is that for declaration to have any practical affect New South Wales would need to fundamentally change the nature and scope of property rights relating to water. It is likely that this would lead to an erosion of rights held by water users who do not seek to or could not avail themselves of services of the type proposed by Lakes R Us. The ability for Lakes R Us customers to, in effect, carry over water entitlements from one year to another will reduce the amount of water that can be allocated among rights holders in a subsequent year. While the proportion of water to which a rights holder is entitled would not necessarily change, the volume from which that proportion is drawn will reduce.
- 6.10 Moreover, because the access proposal involves water diverted to the Murray River, governments would likely need to renegotiate intergovernmental agreements to clarify the water sharing arrangements for the river. The unanimous agreement of the representatives of the New South Wales, Victorian, South Australian and the Australian Governments on the Murray–Darling Basin Ministerial Council would be required to modify the Murray–Darling Basin Agreement (Murray–Darling Basin Commission, sub 10).
- 6.11 Given the nature and complexity of the changes that would be required, and the likely effects on other water users, the Council has significant doubts as to whether governments would implement such changes. Therefore, even if the water storage and release services were declared, it is unlikely that there would be any practical effect on competition.

Outcomes in dependent markets

- 6.12 To satisfy criterion (a) there must be a dependent market(s), other than the market for the service, where access would be likely to promote competition. In this case it is possible to conceive of (potential) dependent markets 'downstream' such as a water trading market in the Murray and Murrumbidgee irrigation areas and to consider the effects of access on competition in such a market. Given the current water management arrangements upstream raw water harvesting and collection markets would not appear relevant to the consideration of the Lakes R Us application.

- 6.13 Lakes R Us considers that Snowy Hydro has a monopoly on the lending of large volumes of water via the ‘Snowy borrow’, which provides a means for irrigators to access pre-season releases from the Snowy Scheme subject to repayment of the water from future allocations. Lakes R Us contends that access to the identified water storage and release services would create opportunities for the promotion of competition in the water lending market. Lakes R Us also considers that access to the services, by promoting more efficient water use and associated water saving, will promote competition in:
- water trading markets by increasing the pool of water available for trade in New South Wales, Victoria, South Australia and, possibly, Queensland
 - agricultural product markets in Australia and elsewhere by encouraging Australian primary producers to enter into agricultural production guarantees
 - peak time electricity generating markets by providing greater flexibility in the use of water to allow increased power generation.

Water lending and trading

- 6.14 Lakes R Us contends that access to the identified water storage and release services would create opportunities for the promotion of competition in the water lending market by allowing it and others to compete with Snowy Hydro’s borrow service.
- 6.15 The Council considers that water lending forms part of a broad water (inter and intrastate) trading market, that is, the Council considers lending to be a substitute for (temporary or permanent) trading in entitlements or licence conversions. Whether the right to extract water is purchased on the trading market or ‘borrowed’ from Snowy Hydro the purchaser or borrower obtains the same product and service; that is a right to extract a volume of water within a specified area. For any given equivalent price (whether specified in monetary terms or other means of exchange), water users will be indifferent as to whether they purchase or borrow the entitlement to extract water.
- 6.16 In most jurisdictions some water entitlements can be traded either temporarily (for an agreed number of seasons) or permanently. Current institutional arrangements for the management of water impose some constraints on the breadth and depth of water trading markets, particularly permanent trading. (Under both the 1994 Council of Australian Governments water reform framework and the

2004 Intergovernmental Agreement on a National Water Initiative, governments recognised such barriers to trade, committing under the National Water Initiative to take action to facilitate trade including by the immediate removal of existing institutional barriers to temporary trade and the phased removal of existing institutional barriers to permanent trade). To the extent that a third party access can help overcome these barriers, it offers the potential to promote competition in the intra and interstate water trading markets in the Murray and Murrumbidgee areas of New South Wales, Victoria and South Australia.

The Snowy Hydro service: effects on competition

- 6.17 Snowy Hydro's operation as a provider of water is governed by the Snowy Hydro Corporatisation Act and its water licence. These impose obligations on Snowy Hydro to release water (minimum annual water release, and in some cases minimum monthly release). They also permit Snowy Hydro to sell (or lend) water under certain circumstances. A key question is the extent to which the ability to participate in water dealing (via the Snowy borrow water lending service) provides the opportunity for Snowy Hydro to exert market power to the detriment of competition in water dealing.
- 6.18 In considering this question, the Council has looked at the extent to which Snowy Hydro would, in the absence of third party access, have the ability and incentive to set fees for its Snowy borrow service above competitive levels, and the effects of such pricing. Relevant to judgments on this matter are potential constraints on Snowy Hydro's capacity to behave in this way, in particular regulatory and supply constraints, the degree to which Snowy Hydro faces competition in the water dealing market from other water suppliers and the countervailing power of Snowy Hydro's customers.
- 6.19 Lakes R Us submits that it believes that Snowy Hydro and State Water behave like monopolists (Lakes R Us, sub 3). Lakes R Us considers that the price of the Snowy borrow demonstrates the extent of Snowy Hydro's market power and its incentive to use that power to maximise returns. Lakes R Us did not, however, provide any evidence that indicates that the price Snowy Hydro charges for the borrow water exceeds the cost of not using the borrow water to generate electricity products.
- 6.20 The Rice Growers' Association submits that:

The [Lakes R Us] application criticises the cost charged by Snowy Hydro to irrigators for the early release and repayment of future year's water. This is clearly an indication of the lack of knowledge of the reasons for the high cost and the business drivers of Snowy Hydro. In reality, the Snowy borrows were a commercial contract between Snowy Hydro and ... irrigation corporations or SunRice...

The cost related entirely to the opportunity cost of forgone electricity generation for Snowy Hydro and did not in any way reflect the cost of water for irrigators. Those irrigators who accepted these deals did so in the light of a commercial business proposition. ... This option will not be available to LRU. (RGA, sub 5, p. 8)

- 6.21 Snowy Hydro must have the permission of the Murray Darling Basin Commission and the New South Wales Government to provide the borrow service. The Murray Darling Basin Commission takes account of a range of factors, such as efficiency, reliability and health and safety matters. In past, the commission has considered, for example, the impact on evaporation losses in the river channels, river and irrigation system capacity to deliver additional volumes of water without causing supply restrictions elsewhere in the system and health and safety matters, including the potential for flooding (MIL 2004). In August 2002, the (then) Department of Land and Water Conservation advised Murray Irrigation that the Snowy borrow developed by Murray Irrigation and Snowy Hydro could not proceed because timely delivery of the water to Hume Dam could not be guaranteed (MIL 2002). Other factors that can also affect the availability of the Snowy borrow include any outstanding water debt from previous borrow arrangements and whether there are sufficient inflows into the Snowy Scheme and regulated river systems to ensure releases can be made available when required (MIL 2003).
- 6.22 Snowy Hydro's behaviour will also be constrained by the overall demand for borrow water. Snowy Hydro provides a bulk water service on an all-or-nothing subscription basis. Where the borrow service is undersubscribed the offer lapses. Murray Irrigation Limited reports that an offer to supply 50 000 megalitres to its shareholders at a cost \$158 a megalitre lapsed in October 2002 because of a lack of subscriptions (MIL 2002). A further offer in October 2004 negotiated with SunRice was supplied at a cost of \$98 a megalitre. SunRice provided an incentive to limit irrigators' borrow cost to \$40 a megalitre plus interest (MIL 2004).

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- 6.23 The availability and price of alternative supplies of water is also relevant. When water has been unavailable from the Snowy Scheme or too expensive Murray Irrigation Limited has taken up opportunities for trade with Victoria (Victorian Water Exchange—Watermove) (MIL 2003). The (then) Department of Land and Water Conservation has also allowed New South Wales irrigators on the Murray River downstream of the Barmah Choke to temporarily transfer water from upstream of the choke or from South Australia.
- 6.24 Beyond this, irrigators may respond to changes in water prices by adjusting their water use. For example, an irrigator growing a crop might respond to an increase in the price of irrigation water by: leaving land fallow and demanding less water; applying less water to the crop and risking some yield loss; switching to less water demanding crops or; investing in more efficient irrigation techniques (Gardner (1983) as reported by Appels et al 2004, p. 1).
- 6.25 The available quantitative evidence indicates that irrigators may be relatively responsive to changes in water prices at least at higher price levels, that is, the demand for water may be price elastic when prices are high.⁶ The Centre for International Economics (2004) reported that a review of the Australian literature reveals that the demand for irrigation water tends to be highly inelastic at prices between \$0 and \$45 a megalitre. Once prices increase above the \$45 to \$50 point, demand begins to fall away and the function becomes elastic. Pagan, Fagan, Crean and Jones (1997) estimated that for prices between \$50 and \$70 a megalitre, the elasticities of demand were -2.8 in the short run and -3.0 in the long run (reported in Appels et al 2005, p. 19). Allowing for a longer time horizon increases the estimate of the responsiveness of water demand because more response options to increasing water prices become available. It allows for example for investment in new irrigation capital (Appels et al 2005).
- 6.26 Given that the Snowy borrow includes a fee and a requirement to repay the water borrowed, it is likely that the total cost of the Snowy borrow exceeds \$45 a megalitre. The cost faced by users of Snowy borrow water is therefore at a level where demand may be relatively elastic. In practice substitution between the Snowy borrow and other

⁶ The price elasticity of demand for water is defined as the percentage change in the quantity of water demanded for a one per cent change in its price. Demand is said to be elastic when the elasticity is greater than one and inelastic when the elasticity is less than one.

water deals may be limited because of the high cost of the Snowy borrow.

6.27 There is some regulatory supervision of the price that Snowy Hydro can charge for the borrow service. The Council understands from discussions with the Department of Infrastructure, Planning and Natural Resources that the department scrutinises the price that Snowy Hydro charges for the borrow service to ensure the price does not exceed the level required to compensate for revenue forgone from electricity sales. The Council has no information, however, on the extent and nature of this scrutiny.

6.28 Lakes R Us appears to believe that Snowy Hydro does not have the ability to further increase its water prices, stating that it:

believes that [Snowy Hydro] is already at the outer boundaries of the market in price and that its customers would refuse to continue purchasing SHL products and seek alternatives. SHL have priced them out of the Snowy Borrow market in the past and will continue to do so in the future. (Lakes R Us, sub 3, p. 21)

6.29 An ability to set prices for water supply services that significantly exceed those in the water dealing market, while indicating that Snowy Hydro has market power, does not necessarily imply an ability and incentive to use that market power to adversely affect competition in the water dealing market. Demand conditions in the water market and the regulatory arrangements governing Snowy Hydro's behaviour suggest that Snowy Hydro may have at most a limited ability to profitably and sustainably raise prices above proper economic costs.

6.30 To the extent that Snowy Hydro is prevented from earning additional profits from water lending (via scrutiny of the borrow price such that it reflects forgone electricity generation income), and given Snowy Hydro does not appear to have a vertically related affiliate that would gain advantage from its participation in water trading, Snowy Hydro may also have limited incentive to exercise market power in the water dealing market.

State Water

6.31 Lakes R Us states that '[w]hat [Snowy Hydro] and State Water do is typical of a monopoly and that is to take every advantage possible and charge the maximum price' (Lakes R Us, sub 3, p. 25). Apart

from stating that these institutions are owned by the states of New South Wales, Victoria and the Australian Government and that profits are diverted to these governments, Lakes R Us did not explain how State Water sets a monopoly price (Lakes R Us, sub 3).

6.32 State Water submits that:

As a creature of statute, SWC's [State Water Corporation] legislative capacity and operation of its storages arises from its constituting legislation and its Operating Licence. In every respect, the exercise of SWC's functions is owed to the elements of compulsion set out in its regulating documents. SWC's asset management functions arise as a legal duty compellable only by its statutory regulators.

SWC has limited powers in respect of water flowing in rivers and cannot intermeddle in the exercise of the State's water rights. When the holder of an access licence under the WM [Water Management] Act takes water from a river, the right to do so is a right exercisable against the Minister for Natural Resources. SWC must enable the rights of the access licence holder to extract water, subject to operational rules and constraints.

...Section 6 (3) of the Act, makes the exercise of any of SWC's functions subject to the Operating Licence and any applicable requirements made under the WM Act and the Water Act 1912.

The three principal instruments which govern the exercise of powers and functions by SWC are:

- *SWC's Operating Licence;*
- *SWC's Water Management Works Approval granted under the WM Act; and*
- *Various Water Sharing Plans made by the Minister for Natural Resources under section 51 of the WM Act.*

The exercise of powers and functions by SWC is also constrained by the provisions of Section 9 (2) of the WM Act, which provides:

Section 9—Act to be administered in accordance with water management principles and State Water Management Outcomes Plan

- (1) *It is the duty of all persons exercising functions under this Act:*

- (a) *to take all reasonable steps to do so in accordance with, and so as to promote, the water management principles of this Act, and*
 - (b) *as between the principles for water sharing set out in section 5 (3), to give priority to those principles in order in which they are set out in that subsection.*
- (2) *It is the duty of all persons involved in the administration of this Act to exercise their functions under this Act in a manner that gives effect to the State Water Management Outcomes Plan.*

...The IPART involvement in price determinations is a significant requirement on State Water as a “service provider” of rural water supply. IPART sets the maximum price limits and price paths on rural bulk water supply charges. (State Water, sub 1, p. 4–6)

6.33 The regulatory framework within which State Water operates gives State Water little discretion on the price or volume of water released. The Act, the operating licence and related water sharing plans impose requirements in relation to price, service standards and quality. As such, there is considerable regulatory constraint on State Water’s ability to behave in a way that reduces competition in the water trading market.

Agricultural markets

6.34 Water diverted from the Snowy system, along with other inflows, is supplied to water users in the Murray and Murrumbidgee irrigation areas. The irrigation water is used as an input into the production of a range of agricultural commodities such as rice and other cereals, fruit, wine, vegetables, dairy and meat products.

6.35 Such goods are traded nationally and internationally and are subject to competition globally because of the high degree of substitutability between raw commodities (such as wool and cotton) and between food products. Australian rice, for example, is sold into over 70 major international destinations and represents around 4 per cent of world trade in rice. Australia’s rice industry competes with other rice, cereal and food producers, including wheat and potato growers.

6.36 Noting that agricultural markets are already competitive, third party access to the water storage and release services of Snowy Hydro and State Water would be unlikely to materially alter the

environment for competition. The Council considers therefore that agricultural markets should not be considered as dependent markets in which third party access to the Snowy Hydro and State Water services would promote competition.

- 6.37 Lakes R Us points to efficiency and productivity benefits that it considers may arise from third party access to the water storage and release service. Such matters are not relevant to consideration of criterion (a), but may affect public benefit considerations and therefore are addressed under criterion (f).

Electricity generation market

- 6.38 Snowy Hydro also diverts water to supply power into the National Electricity Market (NEM). It competes with around 86 registered participants in the NEM that supply electricity into a competitive wholesale electricity market where around 165 000 gigawhatthours of electricity are traded annually across the Australian Capital Territory, Queensland, New South Wales, Victoria and South Australia (NEMMCO 2005).
- 6.39 In terms of the product and temporal dimensions of the market Snowy Hydro largely competes to supply peak demand electricity services and higher value renewable energy services. In part this reflects the rapid start and stop ability of the hydroelectricity system, which provides the capacity to handle seasonal (as well as daily) high peak loads. It also reflects the fact that Snowy Hydro does not have sufficient water resources to reliably compete with base load generators, particularly low cost coal and gas-fired generators. Nevertheless, because electricity is a homogenous product hydroelectricity can provide a substitute for base load generation, and therefore competes in the broader wholesale electricity market trading in the NEM.
- 6.40 It is unclear how third party access would promote competition in the electricity generation market. While barriers to entry can arise where access to a resource is ‘monopolised’—in this case the water in the Snowy Scheme that is the key input into hydroelectricity generation process—opportunities to exploit the market power in the electricity derive from competitive conditions in the final product market rather than the input market. Electricity can be generated using a range of competing fuels, including gas, coal and renewable energy sources, such as wind and solar power.

- 6.41 As discussed above, Snowy Hydro uses water to generate electricity to supply a largely homogenous electricity market. It competes with other generators supplying to the NEM. Competition is largely on the basis of price with decisions about supply between peak and off-peak largely determined by generating technology and the relative cost of production.
- 6.42 Third party access to the water storage and release services would not alter the volume of water collected, the quantity of electricity that can be generated using the water or the number of generators in the NEM. It is thus difficult to see how third party access to the water storage and release service could promote competition in electricity generation.
- 6.43 Third party access may result in Snowy Hydro having to alter the timing of its electricity production, which could affect the value and price of electricity in the national system given the relative importance of Snowy Hydro. If this were to reduce opportunities for Snowy Hydro to compete in the electricity generation market then it would create incentives for other generators to increase production or to enter the market so that over the medium to long term the wholesale electricity generation market supplying the NEM would remain competitive.
- 6.44 Third party access to the water storage and release service would therefore be unlikely to materially alter the environment for competition in the electricity generation market. The Council considers therefore that the wholesale electricity generation market supplying the NEM should not be considered as a dependent market in which third party access to the Snowy Hydro and State Water services would promote competition.

Conclusion

- 6.45 For declaration to have any practical affect New South Wales would need to fundamentally change the nature and scope of property rights relating to water. In addition, because declaration could alter water releases to the Murray River, governments would likely need to renegotiate intergovernmental agreements to clarify the water sharing arrangements for the river. These changes would appear to go far beyond those required to remove impediments to competition. Even if the water storage and release services were declared, therefore, it is unlikely that competition would be promoted.

- 6.46 Snowy Hydro, through its participation in the water dealing market via the Snowy borrow, has scope to exercise market power to the detriment of competition in the water dealing market. There are several constraints, however, on Snowy Hydro's ability and incentive to exercise market power to adversely affect competition in a market in Australia or elsewhere. State Water operates in a regulatory environment that limits its discretion on setting the price, timing and volume of water releases. As such State Water's ability and incentive to exercise market power to adversely affect competition in a market in Australia or elsewhere is limited.
- 6.47 Accordingly, the Council considers that the Lakes R Us application in respect of the water storage and release services of Snowy Hydro and State Water does not satisfy criterion (a).

7 Criterion (c): The national significance test

- 7.1 The national significance test under criterion (c) is a test of materiality that places less important facilities outside the scope of part IIIA (box 1, p. 6). While declaration is concerned with access to services rather than facilities, criterion (c) relates national significance to the facility providing the service. In identifying infrastructure of national significance, the Council has regard to the following matters listed in section 44G(2)(c) that relate to the size and importance of the facility.
- 7.2 Lakes R Us states that '[l]ittle need be said about the national significance of the Snowy system' (Lakes R Us 2004, p.10). Lakes R Us noted that the system affects three states and the Commonwealth directly and is a major part of the national electricity generation system.
- 7.3 At paragraph 4.26(a)(i) the Council defined the relevant Snowy Hydro facility as the entire Snowy Scheme excluding Blowering Power Station, which operates as an adjunct to the scheme. In relation to State Water the Council considers that Blowering and Burrinjuck dams are the relevant facility for purposes of assessing the Lakes R Us application for declaration (see paragraph 4.26(b)(i)). Therefore the Council must assess whether these facilities are of national significance.

- 7.4 Snowy Hydro does not dispute that its facility satisfies criterion (c). The scheme captures and diverts water within a catchment area of 5124 square kilometres. It consists of seven power stations (including Blowering Power Station), 16 major dams (with a total storage capacity of 7 000 gigalitres), 80 kilometres of aqueducts, 145 kilometres of interconnected tunnels and a pumping station (Snowy Hydro Limited 2004).
- 7.5 Indeed there is compelling evidence that the Snowy Scheme is of national significance. The scheme supplies about 3 per cent of the electricity in the NEM, which services about 7.7 million energy customers in Queensland, New South Wales, the Australian Capital Territory, South Australia and Victoria. Farmlands irrigated by contributions from the Snowy Scheme produce millions of dollars worth of crops every year for national and international markets.
- 7.6 The State Water facility at Blowering Dam has a capacity of 1 628 000 megalitres and along with Burrinjuck Dam forms a critical component of the water supply system of the Murrumbidgee river system. Management of the airspace of Blowering Dam is also critical to the provision of Snowy Hydro's ancillary services. State Water must reserve airspace to safely accommodate releases of water during emergency electricity generation. Snowy Hydro comments that Blowering Dam is at least regionally significant, and is an integral facility in the provision of water supply in the Murrumbidgee Valley irrigation and regional water supply. Snowy Hydro did not comment on the national significance of Burrinjuck Dam because Lakes R Us did not seek access to the services of this facility in its original application.
- 7.7 The submissions that specifically address the national significance criterion, including those from the Government of South Australia, WWF Australia and Southern Riverina Irrigators, do not raise any issues to suggest that the facilities providing the services subject to the declaration application do not meet the national significance criterion.

Conclusion

- 7.8 The Council considers that, on the basis of the size and importance and interconnection of the Snowy Hydro facility (excluding Blowering Power Station) and the State Water facility, the Lakes R Us application satisfies criterion (c).

8 Criterion (d): The health and safety test

- 8.1 Under criterion (d) the Council must test whether access or increased access to a service provided by a facility poses a legitimate risk to human health or safety.
- 8.2 Some facilities require a degree of spare capacity to provide appropriate safety margins. In addition, access to facilities may need to be governed by conduct codes and operational guidelines. For a service to be declared, third party access must be possible without compromising system and operational integrity and safe operability.
- 8.3 The existence of relevant safety regulations may suffice to satisfy criterion (d) where these regulations deal appropriately with any safety issues arising from access to the facility under consideration. Alternatively, criterion (d) may be satisfied where it is possible to address any safety concerns raised by access to the service through the terms and conditions on which access is provided.
- 8.4 Lakes R Us is not aware of any human health or safety problems that may arise from access to the water storage and release services provided by Snowy Hydro and State Water. Lakes R Us believes that any party seeking access to the water storage and release services of Snowy Hydro and State Water would have to comply with the same health and safety regulations regime as those service providers. Lakes R Us accepts, however, that the storage of water as its proposal intends involves a risk that water may spill more frequently.
- 8.5 State Water notes that it provides airspace in Blowering Dam in accord with the rules in the relevant water sharing plan and the Blowering Airspace Deed (which requires airspace of up to 190 000 megalitres to be maintained for emergency power generation and to avoid unnatural flooding of private property along the Tumut River). State Water argues that providing access to the airspace of Blowering Dam will have an undue risk on safety. State Water appears concerned that access may involve additional use of the airspace and that the granting of access could have a serious impact on its capacity to mitigate the downstream effects of flooding and could have an impact on Snowy Hydro's ability to generate electricity in emergency circumstances. State Water believes that this could increase the risk of a spill. State Water did not provide a detailed

assessment of the possible safety impacts or extent of the increased risk that may result from access. It indicated that there is insufficient detail in the application to provide a fuller assessment.

- 8.6 State Water does not consider there to be any specific health issues arising from third party access to its water storage and release service, but notes that this could depend on the terms and conditions applying to access.
- 8.7 Snowy Hydro has not raised any specific issues regarding human health and safety.
- 8.8 The South Australian Government does not consider that access to water storage and release services can be provided without any undue risk to human health and safety. It did not provide any information to support its view.

Assessment

- 8.9 Snowy Hydro and State Water are subject to an extensive regulatory regime covering health and safety matters across the spectrum of operations, including rules relating to water, occupational health and safety, planning and the environment.
- 8.10 Arrangements are in place to minimise the risk of a spill.
- (a) Under its water licence Snowy Hydro must prepare a safety management plan and is subject to a range of performance and operating rules designed to mitigate floods. Maintenance of airspace in the Snowy Hydro facility and Blowering Dam is a key safety measure to mitigate the risk of floods and to provide capacity for emergency power generation.
 - (b) Under the Blowering Airspace Deed State Water maintains an airspace volume of up to 190 gigalitres to accommodate water released by Snowy Hydro during emergency power generation. It also maintains airspace and manages water releases so as to mitigate the risk of floods downstream of Blowering Dam.
- 8.11 The Council accepts that third party access may increase the risk of spills. It notes, however, that the Snowy Scheme and the related State Water facilities have been designed and are managed in a way that caters for considerable variation in hydrological conditions.

Given this the Council considers that third party access to the water storage and release service would be unlikely to add significantly to existing water management risks. The Council sees no reason why existing health and safety regulations would not continue to operate and why they could not apply to third parties. In addition, it is open to parties to negotiate terms and conditions of access to appropriately address health and safety concerns.

Conclusion

- 8.12 The Council is satisfied that access to the water storage and release services of Snowy Hydro and State Water can be provided without undue risk to human health and safety. Accordingly, the Council considers that the Lakes R Us application satisfies criterion (d).

9 Criterion (e): The effective access regime test

- 9.1 Under criterion (e) infrastructure services already covered by an ‘effective access regime’ cannot be declared for access under part IIIA (box 2.1, p. 6). The main purpose of criterion (e) is to allow state or territory governments to develop industry-specific access regimes compliant with the Competition Principles Agreement that apply to the exclusion of part IIIA (see appendix B).
- 9.2 The term ‘effective access regime’ is not defined in the TPA. A guide to its meaning is found in s44G(3) which provides that when considering whether an access regime established by a state or territory amounts to an effective access regime, the Council must apply the relevant principles in the Competition Principles Agreement.
- 9.3 In the Sydney Airport decision, the tribunal determined that a state or territory access regime that the Commonwealth Minister has decided is an effective access regime (under sections 44M and 44N of the TPA) meets criterion (e). In assessing the matter, the Council also has regard to:
- whether outcomes produced by the regime are efficient

- whether the regime is legally enforceable for all interested parties
- whether the regime reflects the principles embodied in clause 6 of the Competition Principles Agreement.

9.4 Lakes R Us submits that although the water allocation systems are in place these do not constitute an effective access regime for the purposes of criterion (e).

9.5 There is no state access regime determined as effective under sections 44M and 44N of the TPA that cover the water storage and release services provided by Snowy Hydro and State Water.

9.6 In the issues paper the Council sought views on whether the regulatory arrangements governing water ownership and rights to collect, store, take and use water, particularly those rules relating specifically to the Murrumbidgee and Murray river systems, provide an effective access regime. In response, Murray Irrigation Limited stated that '[t]he assumption and experience of Murray Irrigation is that the current regulatory regime provides enforceable rights ...' (MIL, sub 4, p. 12). State Water (sub 1, p. 17) commented that:

...The Water Sharing rules... were negotiated over a long period of time and are the result of various compromises made by all of the various stakeholders. ...The present access regime provided for in the [Water Sharing Plans] gives effect to a balance struck between the competing claims for the available water. The rules relating to the carrying over of water were agreed to by the peak stakeholder bodies representing the majority of irrigators and thus it is submitted that it is an effective regime.

The rules do not, however, provide for third party access to infrastructure services. Rather access to the service and provision of the service is subject to regulation.

9.7 The New South Wales water management system is legally enforceable and, among other things, has the objective of providing for the efficient sharing of water from water sources. However, the regime does not embody many of the principles in clause 6 of the Competition Principles Agreement. A cornerstone of the clause 6 principles is that third parties should be able to establish commercial negotiations in determining access outcomes (see clauses 6(4)(a)–(c), appendix B) recognising 'access to a service for persons seeking access need not be on exactly the same terms and conditions'. Such opportunities are not available under the New South Wales water management system or those of other states and territories.

Conclusion

- 9.8 The water storage and release services provided by Snowy Hydro and State Water are not the subject of an effective access regime. Accordingly, the Council considers that the Lakes R Us application satisfies criterion (e).

10 Criterion (f): The public interest test

- 10.1 Section 44G(2)(f) (criterion (f)) requires that access (or increased access) to the service would not be contrary to the public interest. The test is whether there are any matters, other than those addressed by criteria (a)–(e), that would lead to the conclusion that declaration would be contrary to the public interest. The Council adopts a broad view of the types of matters that may raise public interest considerations.
- 10.2 In considering criterion (f), the Council must be satisfied that the overall costs of declaration do not outweigh the overall benefits. Because criterion (f) is phrased in the negative, to recommend not to declare where criteria (a) to (e) are satisfied would require the Council to be satisfied that the costs of regulated access outweigh the benefits.
- 10.3 The extent of benefits depends on the likely effect on competition considered under criterion (a). Where criterion (a) is not met, that is, declaration is not likely to promote competition in the dependent market it largely follows that declaration would not be in the public interest. However, to assist consideration of the application, the Council has outlined the arguments presented by Lakes R Us and other parties that relate to criterion (f).

The application

- 10.4 Lakes R Us submits that access to the water storage and release services of Snowy Hydro and State Water would be in the public interest pointing to efficiency, environmental and resource allocation improvements. Lakes R Us considers that declaration of the services would promote competition in the temporary water trading markets

delivering more choice and providing incentives to improve service delivery and/or reduce prices. Better use of the storage capacity in the Snowy Scheme could reduce water industry costs by reducing evaporation and the need for capital investment in temporary storage facilities further downstream. In particular, Lakes R Us considers that improved access to secure high quality water storage would encourage irrigators to invest in water saving technologies. This could provide on-farm productivity gains by helping to improve average yield and by enabling farmers to better plan and manage their operations. On-farm productivity improvements, by improving Australia's global competitiveness, could promote export growth and provide benefits to consumers through greater choice and/or price reductions.

- 10.5 Lakes R Us argues that any water savings achieved through access to the water storage and release services could be used for a number of beneficial alternative purposes. It could be used, for example, to:
- increase the supply of irrigation water during drought times
 - enhance environmental water allocations or provide additional flexibility as to the timing of environmental water releases
 - enhance the ability of hydroelectricity generators to respond to spikes in demand for electricity or for other emergency generating purposes.
- 10.6 Lakes R Us also contends that there are likely to be environmental benefits from encouraging better use of water, including that runoff pollution from fields and pastures would be reduced.
- 10.7 Lakes R Us provides some examples of the ways it considers its proposal might benefit the agricultural sector by increasing the supply of irrigation water during periods of drought, including by presenting estimates of likely gains. In the dairy industry, for example, Lakes R Us indicates that optimal application of water during drought years could improve feed production by up to 300 per cent by increasing dry matter production from 0.5 tonnes a megalitre to 1.5 tonnes a megalitre. Lakes R Us considers that if such a benefit could be realised 3 times in 10 years, the benefit to the industry from storing 400 000 megalitres of water for this purpose could be \$74 million a year. Lakes R Us did not provide evidence, however, to indicate whether such gains are achievable in practice. It has also not taken into account any costs that might be imposed on affected parties from altering the current water management

arrangements. The Council considers it therefore cannot rely on the estimates of benefits presented by Lakes R Us.

- 10.8 That said, the Council recognises that more robust water markets and increased water trading would likely benefit Australia. Early minimal water trading in New South Wales (1997-98), increased the value of irrigated agriculture by \$65 million (Feil 2003). With diversions from the Murray Darling Basin capped since 1995 (to help prevent further degradation of the basin's waterways), water trading provides significant opportunities to achieve greater efficiency in the use of the basin's water. Because irrigators can benefit financially by selling water, they have an incentive to improve their water use efficiency and sell part or all of their water savings. Irrigators can choose to sell all of their annual allocation, which would mean that this water is used for higher-valued purposes. There could also be environmental benefits from trading, where for example water moves from degraded areas to areas that are more suited to irrigation.

Assessment

- 10.9 As discussed under criterion (a), if the facilities subject to the Lakes R Us application were declared, there would also need to be a change in New South Wales's water management arrangements to enable third parties to use the declared services. The necessary changes would involve, among other things, amendments to legislation and water sharing plans that may affect the rights of other parties. Therefore, a significant issue in considering criterion (f) is whether declaration would be contrary to the public interest because it would require changes that affect the existing water extraction rights of other parties.
- 10.10 Current water regulation arrangements also encompass environmental objectives and several participants are concerned that declaration may result in water use outcomes that have adverse environmental impacts.
- 10.11 In addition, access regulation may impose other direct and indirect costs, including the costs associated with negotiating access arrangements and impacts on the electricity industry.

Arrangements for water allocation and use

10.12 In 1994, the Council of Australian Governments agreed to a water resource policy and strategic framework to reform the water industry. New South Wales reformed its water policy and administrative arrangements in the Water Management Act. New South Wales developed detailed water sharing rules, as enunciated in water sharing plans for regulated and unregulated water sources, over the period 2002–04. The overarching objective of the Water Management Act as enunciated in section 3 is:

...to provide for the sustainable and integrated management of the water source of the State for the benefit of both present and future generations.

10.13 New South Wales signed the Intergovernmental Agreement on a National Water Initiative in 2004, thus committing to promote more efficient and effective use of water including desired environmental outcomes.

10.14 As noted by State Water the water sharing plans, which result from the reform process in New South Wales, ‘are the product and expression of an exhaustive and extensive consultative and collaborative process which engaged the various parts of the community’ (sub 1, pp. 16–17). State Water considers that the Water Management Act and the water sharing rules and regimes achieve an outcome that satisfies most stakeholders and communities. Therefore, in the view of State Water, to upset the current water sharing arrangements would be contrary to the expression of public interest and would require the repeal of water management arrangements only recently and almost universally agreed to.

10.15 Lakes R Us points to similarities between its proposal and the Snowy borrow. There is, however, a key difference in that the Lakes R Us proposal would operate each water year over an extended period whereas the Snowy borrow is negotiated as required. In particular, Lakes R Us seeks to remove the time limit on the entitlement to extract water and remove limits on carryover (noting that Lakes R Us does not insist that third party access apply to high security allocation). It also seeks to extend allocation rights beyond those in the water sharing plans, by enabling allocation holders to ‘swap’ water into the Snowy Scheme and trade that allocation.

10.16 Significantly, a water storage service as envisaged by the Lakes R Us proposal would affect the rights of a range of water users. The

current water allocation system in New South Wales largely operates on a ‘use it or lose it’ basis, with some flexibility for carryover. Any remaining unused water at the end of the water year becomes common property available for reallocation in the following year to general security and supplementary water users (noting that total diversions are limited under the Murray–Darling Basin Commission Cap). Thus the Lakes R Us proposal would, in some years, have the effect of reducing the volume of water available for reallocation. Marsden Jacob Associates (2005, pp. 8–9) adds, that because the existing rivers and structures are severely constrained at the multiple points during the irrigation peak, individual irrigators could be further affected if third party users of the Snowy Scheme water release service are given any priority other than last in the bulk delivery system.

10.17 The Rice Growers’ Association considers that in effect the Lakes R Us proposal seeks to instigate a capacity sharing model⁷ for the Snowy storages only. It considers that this could not be implemented without a change from annual water accounting in the New South Wales Murray and Murrumbidgee valleys. While acknowledging that there may a number of advocates for a capacity sharing approach, it considers that no decision should be made without a complementary full investigation of the benefits and disbenefits for New South Wales irrigators. The association also considers that such an investigation should also include a full assessment of the impacts on the Murray–Darling Basin Agreement.

10.18 State Water added that

[t]here are carry-over policies in relation to State shares of Murray waters through a “Continuous Accounting” policy. This provides for accounting of the two upper States’ use of Murray waters not just for one year as is the policy applying to individual water users but progressive carry-over for the long term, subject to specified operational criteria. Irrigators in the Murray are well aware of the policy variation.

...in the 1980’s when the Murray-Darling Basin Commission were contemplating introduction of the upper States’ sharing on a continuous basis rather than on an annual basis, some water users opposed that policy, on the grounds that they would suffer loss of annual supplies.

⁷ Capacity sharing is a method of operating a water storage (sharing of the storage capacity, inflows and system losses) and downstream flows whereby the available storage is divided into vertical shares that meet the shareholder’s water demand.

They preferred the Annual Accounting, which gave NSW access to all unused allocation of both NSW and Victoria. Following Murray-Darling Basin Commission's approval of the policy, there has been little interest in Continuous Accounting for individual irrigators. High water users see an advantage of annual accounting with limited carry-over and more flexible market policies, as these lead to either any unused water at the end of a season being available for sharing among all irrigators and thus increasing the allocation levels or greater quantities of water available on the market. Smaller water users would favour higher carry over provisions. (sub 1, pp. 7–8)

- 10.19 Both Marsden Jacob Associates and the Rice Growers' Association note that third party effects can occur across jurisdictions. Under the continuous accounting rules of the Murray–Darling Basin Agreement New South Wales and Victoria are permitted to carry over water in the common storage facilities, such as Hume and Dartmouth dams. Each state is able to use half the storage capacity. Above this level, the water accrues to the other state. The Lakes R Us proposal by potentially reducing New South Wales's requirement for carryover in the common storages may therefore reduce water available to Victoria. Similarly, where third party access reduces flows to Menindee Lakes it would also reduce the share of water available to Victoria.
- 10.20 Some participants are concerned that third party access to the water storage and release service could compromise the achievement of the stated environmental goals. WWF Australia comments that the Lakes R Us proposal 'vitiates existing carry-over and trading regulations (i.e. it is effectively 'carry-over' by loophole) leading to unknown and unregulated outcomes, potentially to the detriment of the environment' and 'without proper safeguards, ...potentially undermines government investment in water recovery', such as the Living Murray initiative (sub 7, p. 1). While WWF Australia acknowledges that there could be environmental benefits from lower evaporation and a reduction in the unproductive use of water at the end of the season, in the absence of any hard analysis, it could not be 'confident that the environment would win at the end of the day' and considered that 'implementation of [National Water Initiative] accounting and planning requirements should be given priority' (sub 7, p. 4).
- 10.21 Marsden Jacob Associates (2005) considers that third party access to the water storage and release service would have environmental impacts by further altering the natural pattern of river flows,

including by reducing the incidence of floods and spills. It would also result in more water being stored in the Snowy Scheme displacing water normally stored in the mid to lower dams under the current water sharing arrangements. The Snowy Scheme storages spill infrequently, around 1 in 50 years, while spills tend to occur every few years in the lower dams. Marsden Jacob Associates (2005, p. 10) states that:

The reduction in spills would reduce flows into red gum forests, wetlands and billabongs, the latter being essential to preserve appropriate nutrient and breeding cycles. Thus the LRU proposal would confound the intent of governments as expressed in the [National Water Initiative], Living Murray and Water For Rivers to improve the environmental condition and sustainability of the river systems.

- 10.22 Snowy Hydro considers that further altering the pattern of storage, water movement and releases in the Snowy Scheme and the Murray and Murrumbidgee river systems to cater to the demands of third parties may have adverse consequences for the natural environment. It notes that increasing the chance of spills, from the Snowy Hydro and State Water storages, for example, risks significant damage to the natural environment and may reduce the environmental effectiveness of the Murray–Darling Basin Commission Cap where it reduces capacity to provide minimum environmental water flows.

Other costs of declaration

- 10.23 Access regulation imposes costs on third party access seekers, service providers and regulators associated with negotiating access arrangements. In the event of an access dispute there would be added costs for arbitration and dispute resolution.
- 10.24 The Lakes R Us proposal would also overturn Snowy Hydro's exclusive right to store and release the water collected in the Snowy Scheme. While the Snowy Hydro Corporatisation Act requires that Snowy Hydro be compensated for any loss of income that results from third party impacts related to providing water to downstream users, Snowy Hydro considers that access would also have a direct impact on the timing and amount of electricity sent out, spot prices and existing obligations under derivative contracts in NEM. It believes such outcomes would reduce the efficiency and reliability of NEM services and have material economic consequences for Snowy Hydro and other participants in the NEM.

- 10.25 The Council has not assessed the impact on the electricity sector in detail. As noted at paragraph 6.43, however, it considers that third party access would likely affect the value and price of electricity, given the relative importance of Snowy Hydro to the supply of power into the NEM and its role in supplying risk management services. Thus the Lakes R Us proposal could have an adverse impact on electricity industry suppliers and users throughout south-eastern Australia.

Conclusion

- 10.26 The Lakes R Us proposal provides a means to improve water use efficiency, which could potentially deliver significant benefits to the economy. However, the proposal would substantially alter existing water allocation arrangements and this has the potential to impose significant costs on a range of parties, including state governments, water users and the environment.
- 10.27 The Council is not satisfied that access (or increased access) to the water storage and transport services provided by Snowy Hydro and State Water would not be contrary to the public interest—that is, it considers that the Lakes R Us application does not satisfy criterion (f).

11 Exercise of residual discretion

- 11.1 The Council has a residual discretion to recommend against declaration even if all of the declaration criteria in section 44G(2) are satisfied. This residual discretion includes consideration of the matters in sections 44F(3) and 44F(4) (see appendix A).

Section 44F(3): Application not in good faith

- 11.2 Section 44F(3) states that the Council may recommend that the service not be declared if the Council thinks the application was not made in good faith. The subsection does not limit the grounds on which the Council may decide to recommend that the service not be declared.

- 11.3 The Council has received a number of submissions that express concern about the Lakes R Us application. Many submitters found aspects of the Lakes R Us application with respect to the services of Snowy Hydro and State Water confusing and difficult to understand. However, no submission argues that the Lakes R Us application for declaration has not been made in good faith. The Council has no reason to conclude that the application has not been made in good faith and as such, it does not exercise its residual discretion under section 44(3).

Section 44F(4): Consideration of alternative facilities

- 11.4 Section 44F(4) requires the Council to consider whether it would be economical for anyone to develop another facility that could provide part of the service. This issue is related to but distinct from the consideration of natural monopoly under criterion (b).
- 11.5 The issue in the case of the Lakes R Us matters is whether it would be economical for anyone to develop another facility to provide part of the water storage and release service provided by the Snowy Scheme and the State Water dams. These facilities are natural monopolies and satisfy criterion (b).
- 11.6 Several interested parties, including Snowy Hydro, assert that alternative mechanisms and facilities exist, or could be developed, that could economically and efficiently deliver water into the Murray and Murrumbidgee river systems (see the discussion under criterion (b) for details).
- 11.7 Given its conclusions on criteria (a) and (f), the Council has not at this stage considered whether section 44F(4) is satisfied in respect of the Lakes R Us application for declaration of the water storage and release services of Snowy Hydro and State Water.

Appendix A: Sections 44F & 44G of part IIIA

Section 44F: Person may request recommendation

- 44F(1) [Written application to Council] The designated Minister, or any other person, may make a written application to the Council asking the Council to recommend under section 44G that a particular service be declared.
- 44F(2) [Council must act] After receiving the application, the Council:
- (a) must tell the provider of the service that the Council has received the application, unless the provider is the applicant; and
 - (b) must recommend to the designated Minister:
 - (i) that the service be declared; or
 - (ii) that the service not be declared.
- 44F(3) [Application not in good faith] If the applicant is a person other than the designated Minister, the Council may recommend that the service not be declared if the council thinks that the application was not made in good faith. This subsection does not limit the grounds on which the Council may decide to recommend that the service not be declared.
- 44F(4) [Consideration of alternative facilities] In deciding what recommendation to make, the Council must consider whether it would be economical for anyone to develop another facility that could provide part of the service. This subsection does not limit the grounds on which the Council may decide to recommend that the service be declared or not be declared.
- 44F(5) [Withdrawal of applications] The applicant may withdraw the application at any time before the Council makes a recommendation relating to it.

Section 44G: Limits on the Council recommending declaration of a service

- 44G(1) [Access undertakings] The Council cannot recommend declaration of a service that is the subject of an access undertaking in operation under section 44ZZA.
- 44G(2) [Council to be satisfied of matters] The Council cannot recommend that a service be declared unless it is satisfied of all of the following matters:
- (a) that access (or increased access) to the service would promote competition in at least one market (whether or not in Australia), other than the market for the service;

- (b) that it would be uneconomical for anyone to develop another facility to provide the service;
 - (c) that the facility is of national significance, having regard to:
 - (i) the size of the facility; or
 - (ii) the importance of the facility to constitutional trade or commerce; or
 - (iii) the importance of the facility to the national economy;
 - (d) that access to the service can be provided without undue risk to human health or safety;
 - (e) that access to the service is not already the subject of an effective access regime;
 - (f) that access (or increased access) to the service would not be contrary to the public interest.
- 44G(3) [Effective access regimes] In deciding whether an access regime established by a State or Territory that is a party to the Competition Principles Agreement is an effective access regime, the Council:
- (a) must apply the relevant principles set out in that agreement; and
 - (b) must not consider any other matters.
- 44G(4) [Council to follow Minister's decision] If there is in force a decision of the Commonwealth Minister under section 44N that a regime established by a State or Territory for access to the service is an effective access regime, the Council must follow that decision, unless the Council believes that, since the Commonwealth Minister's decision was published, there have been substantial modifications of the access regime or the relevant principles set out in the Competition Principles Agreement.

Appendix B: Competition Principles Agreement (extract)

- 6(2)** The regime to be established by Commonwealth legislation is not intended to cover a service provided by means of a facility where the State or Territory Party in whose jurisdiction the facility is situated has in place an access regime which covers the facility and conforms to the principles set out in this clause unless:
- (a) the Council determines that the regime is ineffective having regard to the influence of the facility beyond the jurisdictional boundary of the State or Territory; or
 - (b) substantial difficulties arise from the facility being situated in more than one jurisdiction.
- 6(3)** For a State or Territory access regime to conform to the principles set out in this clause, it should:
- (a) apply to services provided by means of significant infrastructure facilities where:
 - (i) it would not be economically feasible to duplicate the facility;
 - (ii) access to the service is necessary in order to permit effective competition in a downstream or upstream market; and
 - (iii) the safe use of the facility by the person seeking access can be ensured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist; and
 - (b) incorporate the principles referred to in subclause (4).
- 6(4)** A State or Territory access regime should incorporate the following principles:
- (a) Wherever possible third party access to a service provided by means of a facility should be on the basis of terms and conditions agreed between the owner of the facility and the person seeking access.
 - (b) Where such agreement cannot be reached, governments should establish a right for persons to negotiate access to a service provided by means of a facility.
 - (c) Any right to negotiate access should provide for an enforcement process.
 - (d) Any right to negotiate access should include a date after which the right would lapse unless reviewed and subsequently extended; however, existing contractual rights and obligations should not be automatically revoked.

- (e) The owner of a facility that is used to provide a service should use all reasonable endeavours to accommodate the requirements of persons seeking access.
- (f) Access to a service for persons seeking access need not be on exactly the same terms and conditions.
- (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.
- (h) The decisions of the dispute resolution body should bind the parties; however, rights of appeal under existing legislative provisions should be preserved.
- (i) In deciding on the terms and conditions for access, the dispute resolution body should take into account:
 - (i) the owner's legitimate business interests and investment in the facility;
 - (ii) the costs to the owner of providing access, including any costs of extending the facility but not costs associated with losses arising from increased competition in upstream or downstream markets;
 - (iii) the economic value to the owner of any additional investment that the person seeking access or the owner has agreed to undertake;
 - (iv) the interests of all persons holding contracts for use of the facility;
 - (v) firm and binding contractual obligations of the owner or other persons (or both) already using the facility;
 - (vi) the operational and technical requirements necessary for the safe and reliable operation of the facility;
 - (vii) the economically efficient operation of the facility; and
 - (viii) the benefit to the public from having competitive markets.
- (j) The owner may be required to extend, or to permit extension of, the facility that is used to provide a service if necessary but this would be subject to:
 - (i) such extension being technically and economically feasible and consistent with the safe and reliable operation of the facility;
 - (ii) the owner's legitimate business interests in the facility being protected; and
 - (iii) the terms of access for the third party taking into account the costs borne by the parties for the extension and the economic benefits to the parties resulting from the extension.

- (k) If there has been a material change in circumstances, the parties should be able to apply for a revocation or modification of the access arrangement which was made at the conclusion of the dispute resolution process.
- (l) The dispute resolution body should only impede the existing right of a person to use a facility where the dispute resolution body has considered whether there is a case for compensation of that person and, if appropriate, determined such compensation.
- (m) The owner or user of a service shall not engage in conduct for the purpose of hindering access to that service by another person.
- (n) Separate accounting arrangements should be required for the elements of a business which are covered by the access regime.
- (o) The dispute resolution body, or relevant authority where provided for under specific legislation, should have access to financial statements and other accounting information pertaining to a service.
- (p) Where more than one State or Territory regime applies to a service, those regimes should be consistent and, by means of vested jurisdiction or other co-operative legislative scheme, provide for a single process for persons to seek access to the service, a single body to resolve disputes about any aspect of access and a single forum for enforcement of access arrangements.

Submissions and references

Application and Council consultation papers

Lakes R Us 2004, *Application for declaration of certain Snowy Hydro facilities*.

—2005, *Application re Snowy Hydro P/L - Supplementary submission*.

NCC (National Competition Council) 2005, *The Lakes R Us application for declaration of a water storage and transport service*, Issues paper, Melbourne, April.

— 2005, *The Lakes R Us application for declaration of water storage and transport services*, Draft recommendation, Melbourne, September.

Submissions

Snowy Hydro Limited 2005, *Briefing paper to the National Competition Council*, Sydney.

Submissions in response to the issues paper:	
<i>Sub no.</i>	<i>Submitter</i>
1	State Water Corporation
2	Victorian Farmer Federation, Sunraysia Branch
3	Lakes R Us
4	MIL (Murray Irrigation Limited)
5	RGA (Ricegrowers' Association of Australia)
6	Southern Riverina Irrigators
7	WWF-Australia, including an attachment titled 'Key steps to achieve water security'
8	South Australian Government
9	National Water Commission, including, <i>Analysis of the implications of the Lakes R Us PL proposal for national water reform</i> , a paper prepared by Marsden Jacob Associates 2005 for the National Water Commission
10	Murray–Darling Basin Commission
Submissions in response to the draft recommendation:	
<i>Sub no.</i>	<i>Submitter</i>
11	Lakes R Us
12	Snowy Hydro Limited

Other references

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Re Sydney International Airport (2000) ACompT 1 (1 March)

Re Duke Eastern Gas Pipeline Pty Ltd (2001) ACompT 2 (4 May)

Council publications related to declaration matters

The National Access Regime: a Guide to part IIIA of the Trade Practices Act 1974

Part A Overview

Part B Declaration

Part C Certification

Third party access in the water industry, a report prepared for the National Competition Council by Tasman Asia Pacific Pty Ltd

Water

Services Sydney application for declaration of Sydney sewerage network services

Airports

Services provided through Melbourne and Sydney International Airports: application for declaration

The Airside Service provided at Sydney Airport: application for declaration by Virgin Blue

Electricity

Western Power Corporation electrical transmission and distribution services: application for declaration

Rail

Rail line services provided by Queensland Rail: application for declaration from Carpentaria Transport

Hunter Railway Line Service: application for declaration from the New South Wales Minerals Council

Rail lines between Sydney and Broken Hill: application for declaration from Specialized Container Transport

Rail and freight support services in Western Australia: applications for declaration from Specialised Container Transport

Rail line service in Pilbara region, Western Australia: application for declaration from Robe River Iron

Wirrida to Tarcoola rail track service: application for declaration from AuIron Energy Limited

Freight Australia's Victorian rail network services: application for declaration from Freight Australia

Application by Fortescue Metals Group Ltd (FMG) for declaration of a service provided by the Mt Newman and Goldsworthy railway lines

Note: The Council also has a role under the National Gas Code to advise governments on whether particular gas pipelines should be covered under the code. Details are available on the Council's website at www.ncc.gov.au.