



**Applications by Services Sydney for Declaration of Sewage
Transmission and Interconnection Services**

Further Submission to the National Competition Council

22 November 2004

1. INTRODUCTION

This document contains a brief submission of Services Sydney Pty Ltd (**Services Sydney**) to the National Competition Council (**Council**) in reply to the submissions of Sydney Water Corporation (**Sydney Water**) and Frontier Economics (**Frontier**) dated 5 November 2004 in relation to Services Sydney's Application for declaration of sewage Transmission and Interconnection services provided by Sydney Water dated 1 March 2004 (**Application**).

Services Sydney wishes to briefly comment on matters relevant to the declaration recommendation concerning:

- (a) market delineation as it relates to the framework for assessing the promotion of competition; and
- (b) the definition of the relevant facility for the purposes of the Application.

These matters are addressed below. Unless otherwise stated, this submission adopts the defined terms set out in the Application and Services Sydney's submissions to the Council dated 4 June 2004, 19 July 2004 and 24 September 2004.

2. MARKET DELINEATION

In the Application, Services Sydney submitted that access to the Transmission (Transportation) Service and the Interconnection Service would promote competition in, at least, the Sewage Collection Market.¹ In the Draft Recommendation, the Council concluded that access would be likely to promote competition in both the dependant Sewage Collection Market and the dependant Recycled Water Market and that as a result, the Applications satisfy declaration criteria (a).²

Sydney Water has challenged the satisfaction of declaration criteria (a) by seeking to attack the viability of Services Sydney's proposal and the existence of the specific markets in which Services Sydney intends to compete.

Sydney Water contends that the Applications do not satisfy declaration criteria (a) because the dependant Sewage Collection Market cannot be separated from the primary market for Transportation Services and Interconnection Services in the manner proposed by Services Sydney. This conclusion is based upon the claimed inefficiency in separating out the sewage retail activity from certain other activities undertaken by Sydney Water.³ Specifically, Sydney

¹ Services Sydney Application, p18.

² Draft Recommendation, p52.

³ Sydney Water submission dated 5 November 2004, p14.

Water states that the sets of activities grouped together by Services Sydney do not constitute markets because:⁴

- “(i) they separate the customer interface in water services from the customer interface in wastewater services and that separation is likely to be inefficient; and*
- (ii) the group of activities proposed by Services Sydney separates the wastewater distribution activity from the wastewater customer interface and most commentators and industry experts regard that as inefficient.”*

While not intending to provide a detailed rebuttal, Services Sydney makes the following brief observations in reply:

- (a) The question for the Council is whether there are feasible dependent markets in which competition would be promoted. The question of whether the most efficient market structure would integrate water and sewage retail functions and integrate sewage retail and transportation functions is not relevant.
- (b) Services Sydney is seeking to compete with Sydney Water in the provision of (what are from the customers perspective) sewage collection services. As set out in the Application,⁵ providing a sewage collection service requires the undertaking of a number of functions including a sewage retail function, transportation function, treatment function and disposal function. The fact that these functions are integrated does not mean that each of these functions (or a sub-set) can only be efficiently provided by an integrated service provider.
- (c) The Sydney Water and Frontier submissions assert but do not establish the existence of significant inefficiencies associated with the separation of sewage retail functions from certain water retail functions and certain sewage transportation functions.
- (d) There is an air of artificiality in the way that Frontier seeks to prescribe the “correct” market definitions, based on their assessment of efficient market structures. It is worth noting, as the High Court has stated:⁶

“The economy is not divided into an identifiable number of discrete markets into one or other of which all trading activities can be neatly fitted. One overall market may overlap other markets and contain more narrowly defined markets which may, in their turn, overlap, the one with one or more others.”

⁴ Sydney Water submission dated 5 November 2004, p10.

⁵ Services Sydney Application, p5.

⁶ per Deane J, *Queensland Wire Industries Pty Ltd v BHP Ltd* (1989) 167 CLR 177 at 196.

- (e) Further, an application for declaration does not require that an applicant be held to some strict pleading of their dependent market, so that if their suggested market definition can be shown to be say too wide or too narrow, the application must fail.
- (f) Sydney Water and Frontier appear to proceed on a false premise that the Council will actually be determining the structure of the market(s). That is not correct. Declaration merely provides a means by which a third party can gain access to a bottleneck facility. If such access is ultimately not efficient, or is not taken up as access seekers can not compete with a more “efficient” vertically integrated monopolist, then that is a different question. These are normal competitive market forces. However, competition will have been promoted in that the conditions for competition (including potential competition) will have been enhanced.
- (g) In any event, both Frontier Economics and Sydney Water concede that there is a feasible market for the provision of sewage treatment and disposal services.⁷ It is sufficient that access would promote competition in a market for the provision of sewage treatment and disposal services. Clearly, Services Sydney (and other services providers including water recyclers) intend to compete with Sydney Water in relation to water treatment and disposal which in turn leads to the other dependant market in which competition would be promoted (ie supply of recycled water).
- (h) The gains from competition in downstream treatment and disposal are sufficient to justify a stand alone sewage retail function (as demonstrated in Services Sydney’s business case). While the existence of inefficiencies in separating out the sewage retail function is doubted, there would be a trade off in the loss of any such efficiencies against gains from downstream competition which are sufficient to establish a feasible retail function (and hence Sewage Collection Market).
- (i) Competition for retail customers is an important element for competition in sewage treatment and disposal, as this is not simply a question of price, but also of service quality (for example, competition in relation to superior environmental outcomes).
- (j) If there are economies of scale in the combination of certain retailing activities, Services Sydney may seek to enter into arrangements with established utility service providers with existing retail relationships (such as gas, electricity, cable TV, or telecommunications service providers).

⁷ Sydney Water submission dated 5 November 2004, p11.

- (k) If there are efficiencies in combining certain sewage retail and transportation activities (which is doubted), then the outcome of declaration may simply be the negotiation of arrangements in which Sydney Water provides the customer interface with respect to Services Sydney's treatment and disposal services.

3. DEFINITION OF THE RELEVANT FACILITY

In the Application⁸ and Services Sydney's submissions dated 4 June 2004,⁹ 19 July 2004¹⁰ and 24 September 2004,¹¹ Services Sydney has submitted that the Sydney Sewage Reticulation Network should be treated as the relevant facility for the purpose of the Application. This definition is based on a purposeful approach to defining the relevant facility in the context of the services that are the subject of the Application.

In the Draft Recommendation, the Council redefined the services that are the subject of the Application. This redefinition has resulted in the separation of facility defined by Services Sydney into three separate facilities, namely the North Head, Bondi and Malabar Reticulation Networks. Assuming that it is open to the Council to amend the services that are the subject of the Application in this way, the Council would be expected to indicate the reason as to why its' definition of the relevant service is preferred to that of the applicant.

One aspect of separation is that the declaration proposed in the Draft Recommendation may not be adequate to deal with dynamic nature of interconnection over time of the North Head, Bondi and Malabar Reticulation Networks. For example, it is uncertain whether the service and facility definitions set out in the Draft Recommendation could be applied in circumstances in which the North Head, Bondi and Malabar Reticulation Networks (or any two of them) became interconnected.

It is for this reason that Services Sydney's first preference is the alternative definition of the relevant facility set out in Services Sydney's submission dated 4 June 2004¹² and requests that the Council adopt this approach and amend its' definition of the relevant service accordingly. Alternatively, Services Sydney submits that the Council should adopt the definition of the relevant service and facility set out in the Application.

⁸ Services Sydney Application, pp9-10.

⁹ Services Sydney submission dated 4 June 2004, pp2-7.

¹⁰ Services Sydney submission dated 19 July 2004, pp13-15.

¹¹ Services Sydney submission dated 24 September 2004, pp7-9.

¹² Services Sydney submission dated 4 June 2004, p2.