Attachment

1. NSW Government objective for third party access to water industry infrastructure services

The objects of the WICA Access Regime are set out in section 21 of the ***Water Industry Competition Act 2006*** (the WIC Act). They are:

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

This clause conforms with the principle in clause 6(5)(a) of the Competition Principles Agreement that an effective access regime should include an objects clause that promotes the economically efficient use of, operation and investment in, significant infrastructure thereby promoting effective competition in upstream and downstream markets.

Principally, the NSW Government's objective in introducing the WIC Access Regime is to promote greater efficiency in the water industry through facilitating competitive service provision. Efficiency in this regard includes especially dynamic efficiency (innovation), such as in the development of new water sources, particularly recycling.

The NSW Government supports appropriate access arrangements as a means of achieving these objectives.

It is noted that, before the commencement of the WIC Act, the NSW Government did not support the declaration of Sydney Water's sewerage networks under Part IIIA of the ***Trade Practices Act*** (the "National Access Regime"). This was because the NSW Government was committed to developing a State-based effective water and waste-water access regime, and it was not considered to be in the public interest for this regime to be duplicated at the Commonwealth level (see the NSW Government's statement to the Australian Competition Tribunal, which is set out in full in ***Application by Services Sydney Pty Limited*** [2005] ACompT 7, at [92]).

Moreover, the proposed State-based access regime was considered to be superior to declaration under the National Access Regime because, among other things, it would be tailored specifically for the NSW water and waste-water industry and allow for a more integrated approach to industry regulation including the use of a single regulator for retail and access prices, as well as service standards. State based regulation was also considered more appropriate in the absence of a national market for urban water and waste-water. There were also concerns at the time about allowing third party access in advance of the development of an appropriate regulatory regime for the protection of public health, the environment and consumers.

The NSW Government has, however, always fully endorsed the principles of the Competition Principles Agreement, which are now reflected in the WIC Access Regime.

2. *Determination of licensing applications*

The licensing regime

The licensing regulations established under Part 2 of the WIC Act do not form part of the WIC Access Regime. The provisions fall within the portfolio responsibility of the Minister for Water. (The Minister responsible for the WIC Access Regime is the Premier.)

The NSW licensing regulations under the WIC Act apply independently of the Access Regime, and those regulations apply irrespective of whether access is sought under the Access Regime. The requirement to obtain a licence, and the pre-requisites for doing so (including those set out in section 10(4)) apply to all private operators, including those who do not need access to declared infrastructure services or who obtain access to those services through commercial negotiation or under the National Access Regime.

As the Australian Competition Tribunal has recognised, the nature and extent of State governments' powers to regulate in relation to matters such as public health, the environment and consumer protection are unaffected by the National Access Regime and the Competition Principles Agreement (see ***Application by Services Sydney Pty Limited*** [2005] ACompT 7, for example at [198]).

Prospective licence applicants who have particular questions concerning the process for applying for a licence or the conditions that need to be met can direct their queries to IPART, whose role is to receive, consider and make recommendations to the Minister on licence applications.

Section 10(4)(d) of the WIC Act

Section 10(4)(d) of the WIC Act provides that a licence to supply water may only be granted if the Minister is satisfied that sufficient quantities of the water to be supplied by the licensee will have been obtained otherwise than from a public water utility.

This section recognises that publicly-owned water resources (that is, the water captured and stored by public water utilities in dams and reservoirs) are finite and demand for these resources needs to be managed appropriately.

Although new private suppliers are permitted to enter into commercial arrangements with public water utilities to purchase water from their public water sources for re-supply to consumers (at unregulated prices), to ensure that the State's overall supply / demand balance is not adversely affected it is appropriate that those private operators also be required to make a contribution to the supply side. They could do this, for example, through also supplying water derived from sewer or stormwater recycling, alternative rain water capture, or desalination.

As with the licensing provisions generally, section 10(4)(d) applies independently of the WIC Access Regime.

Third party access regimes are, by definition, concerned with access to ***services*** provided by infrastructure. A third party access regime does not, and is not intended to, provide a right to the goods or resources that a person may wish to supply in connection with those services. This is true of the access regime under Part 3 of the WIC Act, as it is also true for the National Access Regime.

For completeness, however, I note that the NSW Government has separately established a regime by which prospective new suppliers of recycled water can be given enforceable rights to draw the contents of sewers. These 'sewer mining' provisions are set out in Part 4 of the WIC Act and Sydney Water Corporation already has in place a sewer mining policy to which those provisions apply.

3. Declaration of certain services in Re Services Sydney Pty Ltd [2005] ACompT 7

The Council has asked whether it is the NSW Government's intention to seek revocation of the declaration under the ***Re Services Sydney Pty Ltd*** decision if the WIC Access Regime is certified.

Under section 44J of the ***Trade Practices Act***, the Council may recommend that a declaration be revoked if it is satisfied that the declaration criteria no longer apply. It appears that the Council is free to make this recommendation on its own initiative. Given that the duplication of regimes is potentially wasteful of Government resources, imposes unnecessary complexity for business, and is contrary to the intent of the ***Trade Practices Act***, the NSW Government considers that it may be appropriate for the declaration under the National Access Regime to be revoked once the WIC Access Regime is certified.

The NSW Government does not, however, have any present intention of making a request to the Council. If the Council does not act on its own initiative to revoke the declaration, the NSW Government considers that it would be a matter for the Board of Sydney Water Corporation (as the service provider whose services have been declared) whether it should request that this be done.

4. Binding non-coverage declarations

Under Division 4 of Part 3 of the WIC Act, proponents of new water industry infrastructure may apply for a binding non-coverage declaration in respect of the services to be provided by that infrastructure. These are designed to provide certainty to investors, reduce regulatory risk and encourage long-term investment.

It is important that access regulation does not inappropriately deter investment in infrastructure. New investment projects that are (or potentially are) subject to access regulation commonly have long asset lives, and estimates of revenue over the life of the asset may be uncertain. An objective of access regulation is to reduce the scope for service providers to appropriate monopoly rent, but also important is provision for returns to investment to appropriately reflect risk (see NCC, ***Guidelines on Certification under Part IIA of the Trade Practice Act***, 2009, at [2.40]).

Although the CPA does not expressly contemplate binding non-coverage declarations being included in an access regime, the availability of binding non-coverage declarations is consistent with the CPA principles.

It is noted that Chapter 5 of the National Gas Law and Part 13 of the National Gas Rules also expressly provide for a binding no-coverage determination exemption for greenfields pipelines.

Under the WIC Act, a binding non-coverage declaration can only be sought for proposed 'new' water infrastructure. This includes infrastructure that has not yet been constructed or commissioned or which has been used for another purpose but is proposed to be converted for use in the water industry.

A non-coverage declaration can only be made if the declaration criteria do <u>not</u> apply to the relevant service that will be provided by the new water infrastructure. A binding non-coverage declaration is not intended to provide protection against declaration for natural monopoly infrastructure that otherwise meets the declaration criteria.

This means that a non-coverage declaration is not an exemption from or modification to the law. Rather, a non-coverage declaration is analogous to a binding ruling (ie., a statement by a regulator as to the proper application of the law to a particular case, which can then be relied upon as binding upon the regulator).

Like binding rulings in other areas, the purpose of a binding non-coverage declaration is to enhance regulatory certainty. It provides a mechanism for investors to obtain a decision from the regulator as to whether a service meets the declaration criteria ***before*** the infrastructure is commissioned, and to have the certainty that the regulator will not change its mind ***after*** the infrastructure is in operation. This reduces regulatory risk and promotes efficient investment decisions.

The binding non-coverage declaration is, however, time-limited (10 years). This time limit recognises the need to balance the two considerations. First, there is the need to ensure that the non-coverage declaration applies for a sufficient period to provide reasonable certainty for investors having regard to investment horizons which, given the nature of this industry, may be up to 50 years (see ***Application by Services Sydney Pty Limited*** [2005] ACompT 7).

Second, there is the need to ensure that the non-coverage declaration does not apply for such a long period that the market conditions might fundamentally change in such a way that services which come to meet the declaration criteria in the future are precluded from being declared.

It is noted that while it is theoretically possible that a service which does not meet the declaration criteria at the time the infrastructure is constructed could subsequently meet those criteria at some time in the distant future, as a practical matter it is highly implausible that this would occur within a 10 year period. Indeed, if anything, it is reasonable to expect that the trend in most cases will be for any such changes to reduce, rather than increase, the likelihood that the declaration criteria will apply. For example, the significance of a service or its status as a monopoly is, if anything, more likely to decrease over time as new competitors enter the market and new technologies are developed.

It is noted that this 10 year time limit is less than the 15 year time limit which applies to no-coverage declarations which can be made under Chapter 5 of the National Gas Law.

The binding non-coverage declaration will also lapse if the nature of the service changes materially within 10 years. Again, the provisions of the Act recognise that a balance is required.

First, there is the need to provide investment certainty, including a recognition that over a 10 year period it is reasonable that the infrastructure may need to be updated and modified in minor respects, without that affecting the basic character of the service or the continued application of the non-coverage declaration. Against this, there is the need to ensure that a service that is so altered in its nature or extent that it has ceased to be the same service as was considered when the non-coverage declaration was made, should not continue to be protected from declaration.

This balance is achieved through section 36 of the WIC Act, which provides that a binding non-coverage declaration will cease to apply if there is a substantial change in the capacity of the infrastructure or the geographical locations it serves (section 36).

5. Review of decisions and determinations

Review of decisions

Under the WIC Access Regime, the Premier, with the advice of IPART, determines applications for coverage declarations, for revocation of coverage declarations and for binding non-coverage declarations. Arbitration determinations made in respect of covered services are made by IPART.

Neither the ***Trade Practices Act*** nor the Competition Principles Agreement requires an access regime to provide for merits review of such decisions in order for it to be considered an "effective access regime". Indeed, clause 6(5)(c) of the Competition Principles Agreement expressly contemplates that an access regime might not allow for merits review (ie., "***Where*** merits review of regulatory decisions is provided…").

In developing the WIC Act, and following an extensive public consultation process, the NSW Government has made a policy decision that an avenue for merits review will not be provided.

It is important here to distinguish between merits review and judicial review. Judicial review is available where there is an error of law in the decision or decision making process. Decisions of the Premier under the WIC Act are susceptible to judicial review under common law. Determinations made by IPART in an arbitration are also subject to judicial appeal under section 38 of the ***Commercial Arbitration Act***.

Merits review, on the other hand, involves a second decision-maker being invested with the same decision-making powers as the original decision maker, and being able to substitute its view of the correct and preferable decision for that of the original decision-make. Essentially, it is an opportunity for persons unhappy with the first decision-maker's decision to get "a second bite of the cherry".

Although the NSW Government agrees that merits review can improve decision-making processes in some circumstances, it also can also increase the potential for regulatory gaming, reduce certainty and increase both regulatory cost and delays.

In addition to the availability of judicial review, the WIC Access Regime has in place a number of measures for guarding against decision-maker error. The most important of these is that the most appropriate decision-maker has been appointed to make the decisions (being the Premier with the advice of IPART in respect of coverage decisions, and IPART in respect of arbitrations). The regime also prescribes certain decision-making processes, including full public consultation prior to making any coverage decision (section 25(1), 29(1) and 33(1) WIC Act).

In addition, in respect of arbitration determinations, IPART has an administrative policy of ensuring that any arbitration is heard by at least two Tribunal members.

The WIC Act also provides that IPART must give the parties a draft determination prior to making a final determination, and must give the parties an opportunity to make submissions in relation to it (section 40(7) WIC Act). This ensures that the parties to the arbitration have the opportunity to raise any concerns or perceived errors before the determination is finalised.

It is similarly proposed that the Premier will, as a matter of administrative policy, provide the applicant and the service provider (if different) with a confidential copy of IPART's report under sections 25(2), 29(2) and 33(2) before making any final decision, and that those parties will be given a final opportunity to make submissions in respect of IPART's recommendations before the Premier's final decision is made.

Enforceability of determinations

Under section 28 of the ***Commercial Arbitration Act*** a determination made by an arbitrator is final and binding on the parties. Further, under section 33, the determination may, with leave of the Court, be enforced in the same manner as a judgment or order of the Court to the same effect and, where leave is so given, judgment may be entered in terms of the determination.

The Act is available at www.legislation.nsw.gov.au

6. Efficiency promoting terms and conditions of access

In relation to the Council's query about the terms and conditions of access (including pricing), it is a matter for IPART, as the independent arbitrator, to apply the pricing principles in accordance with the Act. The NSW Government cannot direct IPART in the application of the pricing principles to particular cases, and nor would it be appropriate for it to attempt to do so.

I note that the pricing principles set out in section 41 are consistent with (indeed, identical to) the pricing principles under the Competition Principles Agreement. There can be no question, therefore, that the WIC Access Regime complies with those principles.

As both the Australian Competition Tribunal and the Australian Competition and Consumer Commission have observed, there are various methodologies that can be used to calculate access prices consistently with the pricing principles.

Section 41(3) of the WIC Act requires only that, of the many different approaches that can legitimately may be taken under those pricing principles, one which is consistent with 'postage stamp' pricing (if it applies) should be preferred.

Postage stamp pricing refers to a system of pricing in which the same kinds of customers within the same area of operations are charged the same price for the same service. It is the NSW Government's policy that postage stamp pricing is to apply in respect of certain water and waste-water services provided by public water utilities.

Section 41(3) of the WIC Act is necessary because some (but not all) of the pricing methodologies that might be consistent with the CPA pricing principles would be inconsistent with the maintenance of postage stamp pricing. For example, under some pricing methodologies access seekers may be able to 'cherry pick' customers in such a way as to undermine the cross-subsidies inherent in the system of postage stamp pricing.

As the Australian Competition Tribunal has stated, "[i]t is the NSW Government's prerogative to determine whether or not postage stamp pricing should be maintained". The Tribunal went on to recognise that there are pricing methodologies available under the CPA pricing principles that are consistent with the maintenance of postage stamp pricing.

In particular, the Tribunal said:

> "As long as access prices do not vary with the location of the customer, there would not be any incentive for cream skimming. This could be achieved either through the use of ECPR [efficient component pricing rule] pricing, as recommended by IPART, or through some average cost approach, including an average building block cost approach." (***Application by Services Sydney Pty Limited*** [2005] ACompT 7, at [205]; see also ACCC, ***Access dispute between Services Sydney Pty Ltd and Sydney Water Corporation***, Arbitration report 19 July 2007, at 42)

The Australian Competition and Consumer Commission (ACCC) has similarly held that pricing methodologies are available which are consistent with both the pricing principles and the maintenance of postage stamp pricing.

Indeed, in the Services Sydney arbitration, even though the ACCC was not under any statutory requirement to prefer a pricing methodology that was consistent with the maintenance of postage stamp pricing, it independently came to the view that such a methodology should be adopted (ACCC, ***Access dispute between Services Sydney Pty Ltd and Sydney Water Corporation***, Arbitration Report 19 July 2007, at 45).

7. Access undertakings

Section 42 of the WIC Act requires a service provider of infrastructure services the subject of a coverage declaration to keep separate accounts and submit a cost allocation manual to IPART. Although this statutory requirement is not imposed directly on service providers whose infrastructure services are subject to an access undertaking, all access undertakings must be approved by IPART, and it is expected that IPART will require similar separation of accounts as a condition of approval of any access undertaking.

8. Period of certification

Under section 44M(5) of the ***Trade Practices Act***, the Council is required, when making a recommendation concerning certification to the Minister, to also recommend the period for which the decision should be in force.

Assuming, of course, that the decision is that the WIC Access Regime be certified, the NSW Government requests that the period for which the decision is to be in force should be at least 25 years and up to 50 years.

In this regard it is noted that the investment horizon for new infrastructure in this industry is long, and it is important that investors (and financiers) be provided with regulatory certainty. Further, the WIC Access Regime has been developed as a principles-based regime to ensure that it has flexibility to adapt to changes in the market environment.

It is relevant that the Australian Competition Tribunal considered 50 years to be an appropriate time to declare services in this industry under the National Access Regime: ***Application by Services Sydney Pty Limited*** [2005] ACompT 7.