



Water

Consultation Paper

2019 Review of Water Third Party Access Regime

November 2018

Request for submissions

The Essential Services Commission (**Commission**) invites written submissions from members of the community on this paper. Written comments should be provided by **Friday, 7 December 2018**.

It is the Commission's policy to make all submissions publicly available via its website (www.escosa.sa.gov.au), except where a submission either wholly or partly contains confidential or commercially sensitive information provided on a confidential basis and appropriate prior notice has been given.

The Commission may also exercise its discretion not to publish any submission based on length or content (for example containing material that is defamatory, offensive or in breach of any law).

Responses to this paper should be directed to: **2019 Review of Water Third Party Access Regime**

It is preferred that submissions are sent electronically to: **escosa@escosa.sa.gov.au**

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Summary

The Third Party Access Regime set out in Part 9A of the Water Industry Act 2012 (**Regime**) provides a framework for the negotiation of access to specified water and sewerage infrastructure services provided by the South Australian Water Corporation (**SA Water**), with the potential for arbitration should negotiations fail.

The key elements of the Regime are:

- ▶ a requirement for SA Water to provide information to potential access seekers in order to facilitate access proposals
- ▶ a negotiation framework under which SA Water and potential access seekers can negotiate an access agreement for a declared service, and
- ▶ a formal dispute resolution framework.

The Essential Services Commission (**Commission**) is appointed as the regulator under the Regime. As the regulator, one of the Commission's functions is to conduct a review of the Access Regime by 30 June 2019 to determine whether it should continue to apply. At the conclusion of its review, the Commission must provide a report to the Minister for Environment and Water and must recommend whether or not the Regime should continue from 1 July 2019 for a further five years.

The Review will focus on the effectiveness of the Regime in addressing the potential for information asymmetries and the misuse of market power by SA Water in dealing with prospective users of the services provided through its water and sewerage infrastructure covered by the Regime.

In that context, this Consultation Paper seeks evidence, information and commentary from stakeholders to assist in the Review. The Commission is particularly keen to hear from parties that have initiated, or have considered initiating, a request for access under the Regime.

The Commission will consult on outcomes to date

SA Water has advised the Commission that no access agreements have been entered into under the Regime, nor has SA Water received any formal applications for access under the Regime. In that context, during the course of this Review, the Commission will consult directly with SA Water and those parties that have commenced negotiations under the Regime in order to understand the reasons for the absence of access agreements under the Regime, and the extent to which agreements are being reached outside the Regime. It will also look to consult directly with parties which have considered but not proceeded with negotiations, in order to understand the reasons for which they chose not to move forward under the Regime.

Assessment methodology

To assess the effectiveness of the Regime, the Commission will need to determine whether or not the Regime helps to facilitate access by addressing the potential for information asymmetries and for SA Water to misuse market power in providing declared infrastructure services. That assessment will allow the Commission to determine if the Regime is achieving its statutory objective, which is:

to promote the economically efficient use and operation of, and investment in, significant infrastructure so as to promote effective competition in upstream and downstream markets.¹

¹ Water Industry Act 2012, section 3(g).

The Commission will undertake that assessment by:

- ▶ understanding the structure of the water industry, which may create opportunities for competition in related markets or, where effective competition is not feasible, give rise to the potential for misuse of market power by SA Water
- ▶ reviewing any evidence of information asymmetries or SA Water misusing market power, by charging inefficient prices for access to declared infrastructure services or otherwise hindering the efficient use of those services, and
- ▶ reviewing whether or not the Regime is itself leading to inefficient outcomes or if there is a better way of promoting the desired outcomes at a lower regulatory cost.

The provisions of the Water Industry Act 2012 (**Act**) require, at least, the Commission to make a recommendation to the Minister as to whether or not the Regime in its current form should continue to apply. In undertaking this Review, the Commission will seek to determine whether or not there is sufficient justification to retain access regulation for the infrastructure services currently declared. The Commission will examine if market or regulatory environments have changed since the introduction of the Regime, or are likely to change during the next five-year period, to determine the appropriateness of the Regime.

The absence of access agreements under the Regime does not, in itself, mean the Regime should not apply, if it is due to factors outside the Regime. The Commission will seek evidence of the factors that may have led to that outcome.

Questions for stakeholders

Stakeholder engagement is a crucial component of this Review, as the views of current and potential access holders will inform the Commission's understanding of, and recommendations on, the effectiveness of the Regime.

Specifically, the Commission is keen to obtain information, evidence and views on the following matters:

- ▶ Have stakeholders sought access to SA Water's infrastructure?
- ▶ Have stakeholders found any barriers to negotiation or to achieving an access agreement?
- ▶ Do stakeholders have views on ways that the Regime may be improved?
- ▶ If a stakeholder had an access arrangement that commenced prior to the introduction of the Regime, has it experienced any changes – either positive or negative?

Noting the current operation of the Regime, the Commission is also interested in any stakeholder information, evidence and views on:

- ▶ any inferences which might be drawn on the lack of successful negotiations under the Regime to date
- ▶ the infrastructure services that are currently within scope of the Regime and whether or not other services should be brought within the Regime (either in full or in part), and
- ▶ the implications of the 'retail minus avoidable cost' pricing methodology direction on SA Water in the context of the objectives of the Regime.²

Stakeholders are also welcome to provide information, evidence and views on any other matters relevant to the Review.

² The "retail minus avoidable cost" pricing methodology is discussed in the section 'Setting of the access price' of this paper.

Regime overview

The Third Party Access Regime for the water industry is established under Part 9A of the Act. The Water Industry (Third Party Access) Proclamation 2016 has been issued under the Act and declares SA Water to be a 'regulated operator' for the purposes of the Regime and prescribes the particular services that are covered by the Regime.³

The regime commenced on 1 July 2016. Section 86C of the Act appoints the Commission as the regulator for the purposes of the Regime.

On 22 May 2017, the then Commonwealth Treasurer, the Hon. Scott Morrison MP, made a decision under Part IIIA of the Competition and Consumer Act 2010 (Cth) to certify the Regime as effective, for a period of ten years.⁴ This means that the alternative pathways for access under Part IIIA of the Competition and Consumer Act 2010 (Cth) (declaration or voluntary access undertaking) are not available during the period of certification.

In essence, the Regime establishes a negotiate-arbitrate framework for access seekers. It requires SA Water to provide specific information to access seekers, on a non-discriminatory basis, to help them formulate an access proposal in relation to the services provided by declared infrastructure. If the parties cannot agree on the terms and conditions of access, a party may refer the dispute to the Commission, which will seek to resolve the dispute by conciliation. If the dispute is not resolved by conciliation, then the Commission may refer it to independent arbitration.

Of note, there is express provision for, and recognition of, commercially negotiated access contracts between SA Water and an access seeker arising outside the scope of the Regime.⁵ Therefore, it is not mandatory for access negotiations to go through the process set out in the Regime.

The Regime's objectives are to:

- ▶ promote the economically efficient use and operation of, and investment in, significant infrastructure so as to promote effective competition in upstream and downstream markets,⁶ and
- ▶ encourage private sector participation in the South Australian water industry, while maintaining protections for the safety and security of the state's water supply, and the health and safety of South Australians.⁷

The objectives are consistent with the requirements of the Competition Principles Agreement,⁸ which sets out a set of general principles against which 'effective' access regimes are assessed. Those principles provide that access to the services provided by a person's significant infrastructure facilities should only occur where:

- ▶ it is not economically feasible to duplicate those facilities
- ▶ such access is necessary to permit effective competition in upstream or downstream markets, and
- ▶ the access can be provided safely at a reasonable cost.

³ A copy of the Proclamation may be accessed from the Commission's website at: <https://www.escosa.sa.gov.au/ArticleDocuments/604/20160701-Water-ThirdPartyAccess-Proclamation-1July2016.pdf.aspx?Embed=Y>

⁴ Refer the National Competition Council's website at <http://ncc.gov.au/application/application-for-certification-of-the-south-australian-water-infrastructure> (accessed 9 October 2018)

⁵ Water Industry Act 2012, section 86ZN

⁶ Water Industry Act 2012, section 3(g)

⁷ See Parliamentary Hansard, 16 June 2016, available at

<https://hansardpublic.parliament.sa.gov.au/Pages/HansardResult.aspx#/docid/HANSARD-10-15914>

⁸ Competition Principles Agreement (an agreement between the Council of Australian Governments) – 11 April 1995 (As amended to 13 April 2007), available at <https://www.coag.gov.au/about-coag/agreements/competition-principles-agreement>

It is noted that access, in this sense, means access to services provided by another person's infrastructure, where that person has made investments in the infrastructure (generally) primarily for its own use. The three-part assessment set out above highlights that access to such private investments should only be required where there is a sound economic basis for doing so.

Review requirements

Under section 86ZR(6) of the Act, the Regime will expire on 30 June 2019 unless:

- ▶ the Commission has, in the report of a review conducted prior to that date, recommended that the Regime should continue in operation for a further prescribed period, and
- ▶ a regulation has been made extending the period of its operation accordingly.

In conducting the Review, section 86ZR of the Act requires the Commission to:

- ▶ give reasonable notice of the Review in a newspaper circulating generally throughout the State, inviting written submissions on the matters under review within a reasonable time specified in the notice
- ▶ consider submissions made in response to the notice and other submissions made in the course of other forms of public consultation undertaken by the Commission in connection with the Review, and
- ▶ forward to the Minister for Environment and Water a report on the Review and the conclusions reached by the Commission as a result of the Review and which must recommend either:
 - that Part 9A should continue in operation for a five-year period, or
 - that Part 9A should expire on 30 June 2019.

The Commission notes that periodic review of this nature is consistent with Clause 6(4)(d) of the Competition Principles Agreement.

Roles and functions under the Regime

As explained above, the Regime establishes a framework for the negotiation of access to certain water and sewerage infrastructure services provided by SA Water, with the potential for arbitration should negotiations fail. The roles of various parties and entities within the Regime are explained below.

The Government and Minister

As the policy maker, the Government (through the Minister for Environment and Water), has overall roles in relation to and under the Regime:

- ▶ determining the extent to which the regime applies to water/sewerage infrastructure or operators (noting that the Governor makes proclamations to give this effect)
- ▶ during arbitration, the Minister can issue a 'direction' to SA Water which an Arbitrator must take into account, and
- ▶ the Minister is to consider the Commission's review of the Regime, which will recommend whether or not the Regime should continue to apply, and then determine whether it should be continued by the making of a regulation to that effect.

The Commission

The Commission's roles under the Regime are as follows:

- ▶ it is the regulator for the purposes of the Regime, and performs an overall compliance and monitoring role
- ▶ it must seek to resolve a dispute by conciliation
- ▶ it determines whether a dispute should be referred to arbitration, and
- ▶ it reports annually on the work carried out by the Regulator as part of the Regime, and conducts reviews of whether or not the Regime should continue.

Services fully covered under the Regime

The Regime applies in full (see the following section for a full description of the Regime's operation) only to services provided by or through declared SA Water infrastructure, which at present comprises the following pipelines:

- ▶ Murray Bridge to Onkaparinga
- ▶ Mannum to Adelaide
- ▶ Swan Reach to Paskeville
- ▶ Myponga to Adelaide
- ▶ Morgan to Whyalla
- ▶ Taillem Bend to Keith, and
- ▶ Glenelg to Adelaide.

Services partly covered under the Regime

Under the terms of the Proclamation, the Regime applies only in part to SA Water's bulk sewage and local sewage networks and other infrastructure and infrastructure services that are necessary for the transport of water or sewage. The relevant parts of the Regime that apply to the services provided by such infrastructure are:

- ▶ provision of an information brochure,⁹
- ▶ provision of information provided on a non-discriminatory basis,¹⁰
- ▶ provision of copies of access contracts to be supplied to the Commission¹¹, and
- ▶ SA Water must supply specified information to the Commission.¹²

This part coverage means that access seekers of these services are not afforded the same level of protection as is the case for the fully-covered services described above. For example, a dispute about the terms and conditions of access to partially covered infrastructure cannot be referred to the Commission for conciliation.

⁹ Section 86F of the Water Industry Act 2012

¹⁰ Section 86H

¹¹ Section 86ZO

¹² Section 86ZP

Exclusions from the Regime

The Proclamation further provides that certain services and infrastructure are excluded from the Regime's scope:

- ▶ infrastructure operated by an irrigation infrastructure operator, if that operator operates the water service infrastructure for the purposes of delivering water for the primary purpose of being used for irrigation, and
- ▶ infrastructure operated by entities other than SA Water.

SA Water's obligations as an access provider

Under the Regime, SA Water must:

- ▶ keep separate accounts and records of the services subject to the Regime, as distinct from other services provided by SA Water
- ▶ provide certain information to the access seeker
- ▶ negotiate in good faith
- ▶ provide information and documents to the Commission
- ▶ comply with a requirement of the Arbitrator, and
- ▶ provide the Commission with notice of any access proposals received and every access contract made.

Access seekers' obligations

In terms of access seekers, the Regime provides that:

- ▶ if SA Water reasonably requires it to, an access seeker must provide further information about its proposal
- ▶ an access seeker must comply with a requirement of the Arbitrator, and
- ▶ an access seeker can terminate arbitration before an award is made, or choose to withdraw from an award.

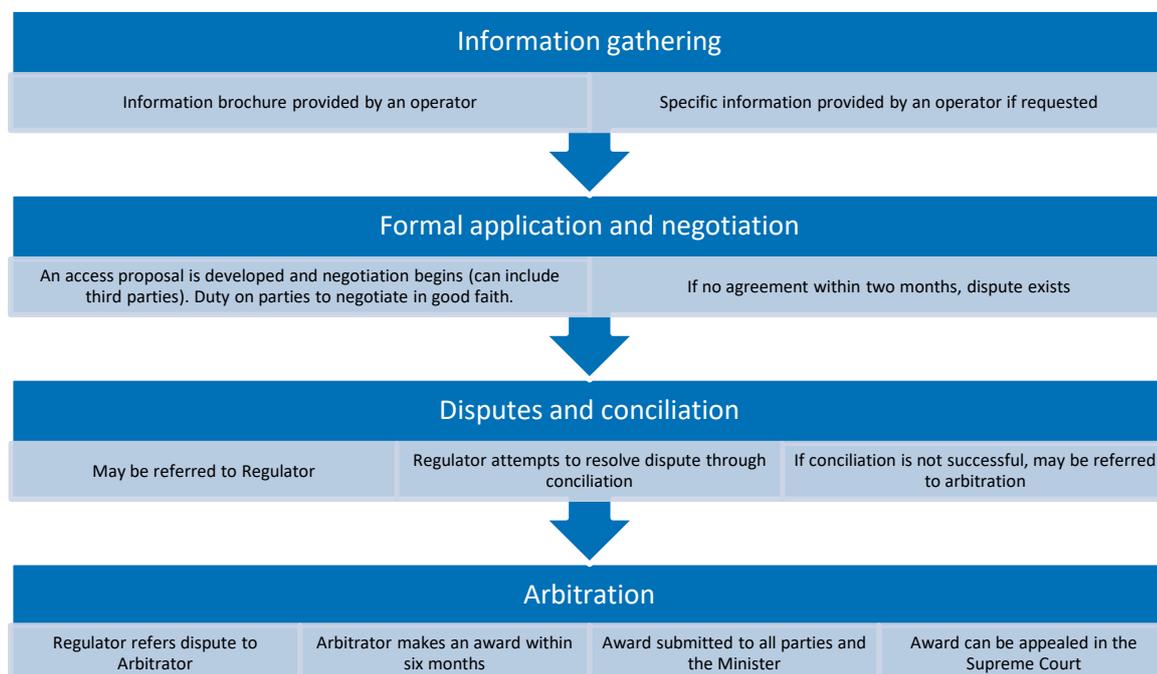
Arbitrator functions

The role of the Arbitrator (appointed by the Commission) under the Regime is to:

- ▶ make an award if conciliation has not been successful
- ▶ obtain information on matters relevant to the dispute in any way that the Arbitrator thinks appropriate
- ▶ take certain principles in the Act into account when making an award, and
- ▶ proceed with the arbitration as quickly as properly is allowed.

The Regime in operation

The Regime's operation is described in detail below. In simple terms, however, the overall operation of the Regime is set out in the following flow chart.



Stage 1: information gathering

The first stage of the process, information gathering, involves the access seeker and the regulated operator seeking and obtaining the relevant information necessary to negotiate access.

This commences with SA Water providing an information brochure. The information brochure is required to contain details necessary for access¹³, such as:

- ▶ the terms and conditions on which SA Water is prepared to make its regulated infrastructure available for use by others
- ▶ the procedures that SA Water will apply in determining a proposal for access to any regulated infrastructure and infrastructure services, and
- ▶ information about relevant prices and costs associated with gaining access to (and using) regulated infrastructure and infrastructure services.

The information brochure must also contain:

- ▶ a copy of a standard access contract used by SA Water, and
- ▶ the contact details of SA Water's representative who is the initial point of contact for responding to questions about access to the regulated infrastructure.

The information brochure should provide 'general information' to assist the potential access seeker. Nevertheless, it is likely that an access seeker will require further specific information from SA Water in order to fully formulate its access proposal.

¹³ Section 86F

The Act contemplates this need and therefore provides¹⁴ that SA Water must provide the potential access seeker with information reasonably requested about:

- ▶ the extent to which the infrastructure is currently being utilised
- ▶ the possibility of altering or adding to infrastructure so that it could meet the access seeker's requirements, and
- ▶ whether the regulated operator would be prepared to provide access:
 - and if so, the general terms and conditions and likely price;
 - and if not, the reasons why access cannot be provided.

This stage is important for both parties, so they can satisfy themselves as to whether or not an access proposal is possible, and if so, whether or not it is viable.

It should be noted that, to this point, a formal access proposal is yet to be submitted by the potential access seeker.

Stage 2: formal application for access and negotiation

A potential access seeker needs to submit a written proposal if it wants access to the services provided by regulated infrastructure, or to vary existing access rights. This is referred to an 'access proposal'. The proposal must set out:

- ▶ the nature and extent of the required access (or variation), and
- ▶ terms and conditions for access (or variation) that the potential access seeker considers reasonable and commercially realistic.

When an access proposal is received, SA Water must notify any third party whose rights would be affected by the implementation of the proposal. It must also give the potential access seeker a preliminary indication of whether or not it is prepared to provide access and on what terms, including advice of any necessary alterations or additions required to be made to the existing infrastructure in order to give effect to the access proposal.

Negotiation

If all terms, conditions and indicative prices are agreeable to the parties, then negotiations can begin.

From the commencement of negotiations, SA Water has a duty to negotiate in good faith with the access seeker, with a view to reaching agreement based on the access seeker's proposal. It may also seek input from other regulatory bodies at this stage (such as the Environment Protection Authority, Health SA or the Office of the Technical Regulator).

Disclosure of the access price

Once SA Water has determined that it would be prepared to provide access to a potential access seeker, it must provide an indication of the likely price at which it would be prepared to provide access.¹⁵

Setting of the access price

During the passage of the Act through the Parliament, concerns were raised that SA Water's existing retail customers could be negatively impacted by new third party access contracts. For example, if third parties were able offer water at a cheaper rate than SA Water could (thereby enticing customers away from

¹⁴ Section 86G

¹⁵ Section 86G(1)(c)(i)

SA Water), then this could result in the remaining SA Water customers needing to cover the fixed costs of infrastructure, potentially at a higher cost per customer.

To address that concern, the then Minister for Water and the River Murray directed (under the Public Corporations Act 1993) that SA Water must set its access prices on the basis of retail prices minus avoidable cost.

This means that the access price is calculated using SA Water's state-wide retail price, minus SA Water's avoidable costs for the designated services, plus any facilitation costs associated with the provision of the designated services.

Avoidable costs are defined as the costs that SA Water would otherwise incur in the provision of retail services to the customer(s) that SA Water could avoid in the long term if it completely ceased provision of the retail service to those customer(s).

In that context, it is to be noted that SA Water's current retail prices:

- ▶ are set on a state-wide basis, meaning that they do not differ by location¹⁶, and
- ▶ vary according to customer type (for example between residential and commercial customers).

Stage 3: disputes and conciliation

Once negotiations begin, the parties have a duty to negotiate in good faith and have two months to reach an agreement. If the parties have negotiated in good faith and have not reached an agreement within that time, a dispute is deemed to exist. Once a dispute exists, a party may refer the dispute to the Commission for conciliation.

Of note, a party may choose not to refer a dispute (deemed or otherwise). This may be the case if, for example, negotiations are continuing in good faith but are taking longer than two months for a sound reason.

Conciliation

If a dispute is referred to the Commission, it must seek to resolve it by conciliation.

Conciliation is a process of attempting to resolve a dispute, where the Commission may provide a non-binding settlement proposal to the disputing parties, avoiding a formal arbitration process.

The Commission is not required to resolve a dispute by conciliation if it believes that the subject matter of the dispute is trivial, misconceived or lacking in substance, or that the parties have not negotiated in good faith.

Stage 4: arbitration, awards and appeals

If conciliation is not successful, or is taking longer than six months, the next stage may be referral to formal arbitration.

Arbitration is a means of dispute settlement between parties by a neutral third party (the Arbitrator) without resorting to court action. It differs to conciliation in that the Arbitrator can make a binding decision on the dispute.

Under the Regime, the Arbitrator is selected by the Commission. An appointment is to be made by the Commission on the basis that the Arbitrator is properly qualified, independent of the parties and the Government and has no interest in the outcome of the dispute.

¹⁶ See the *Ministerial Direction to SA Water*, 23 October 2014, Appendix 3 of the SA Water Price Determination 1 July 2016 – 30 June 2020: Final Framework and Approach, available at https://www.escosa.sa.gov.au/ArticleDocuments/440/20141121-Water-SAWaterPriceDetermination_2016-202.pdf.aspx?Embed=Y

Again, the Commission need not refer a matter to arbitration if it believes that the subject matter of the dispute is trivial, misconceived or lacking in substance, or that the parties have not negotiated in good faith.

Arbitration principles

During an arbitration, the Arbitrator must take into account several matters when making a decision.¹⁷ These include:

- ▶ the terms of the Act
- ▶ SA Water's business interests and investment in the regulated infrastructure
- ▶ the costs of providing access as sought by the potential access seeker
- ▶ the interests and contractual obligations of all parties
- ▶ any operational and technical requirements necessary for the safe and reliable operation of the regulated infrastructure
- ▶ the economically efficient operation of any regulated infrastructure
- ▶ the benefit to the public from having competitive markets
- ▶ any direction given to the regulated operator by its Minister (under the Public Corporations Act 1993) that is relevant to the arbitration (refer the discussion on setting of access prices above)
- ▶ the pricing principles specified in the Act, and
- ▶ any other law or legislative requirement relating to health, safety or the environment, eg Natural Resources Management Act 2004, South Australian Public Health Act 2011.

Award

The Arbitrator's decision is termed an 'award' and an award must be made within six months of arbitration commencing.

If the parties to an arbitration consent to a proposed award, and if the Arbitrator considers the award appropriate, then the Arbitrator may make a consent award.

An access seeker can elect not to be bound by the award within seven days after the making of the award. If this occurs, the access seeker is then precluded from making another proposal related to the same matter within a two-year period and it must bear all costs of the arbitration.

A party may appeal an award to the Supreme Court.

¹⁷ Section 86P

Next steps

The Commission invites written submissions on this paper by **Friday, 7 December 2018**.

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Adelaide SA 5001

The Commission will also directly engage with key stakeholders during the review, particularly existing and potential access holders, to inform its assessment of the effectiveness of the Regime.

The Commission will consider all submissions before releasing a draft report on its initial findings and recommendations in February 2019. The Commission will then undertake public consultation on the Draft Report.

Submissions to the Draft Report will be considered by the Commission in preparing its Final Report on the Review, which will be published in May 2019. The Final Report will contain the Commission's final recommendation to the Minister on whether or not to extend the Regime for a further five years, from 1 July 2019.

