



# 2019 Review of Water Third Party Access Regime

DRAFT REPORT

March 2019

## Request for submissions

The Essential Services Commission (**Commission**) invites written submissions on this draft report. Written comments should be provided by **19 April 2019**

It is the Commission's policy to make all submissions publicly available via its website ([www.escosa.sa.gov.au](http://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.

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

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## Glossary of terms

ACCC	Australian Competition and Consumer Commission
Access Pricing Direction	The direction issued on 24 June 2016 by the then Minister for Water and the River Murray that directed SA Water under the Public Corporations Act 1993 (SA) to use a state-wide retail-minus avoidable cost pricing methodology to determine access prices for all infrastructure services unless directed otherwise by the Minister
Act	Water Industry Act 2012
CCA	Competition and Consumer Act (Cth)
Commission	Essential Services Commission, established under the Essential Services Commission Act 2002
CPA	Competition Principles Agreement
Minister	Minister for the Environment and Water
NCC	National Competition Council
Proclamation	Water Industry (Third Party Access) Proclamation 2016 (SA) made under ss5A and 86B of the Water Industry Act 2012 (SA)
Regime	The regime for regulating third party access to water and sewerage infrastructure services in South Australia, established by Part 9A of the Water Industry Act, as it applies in full to the infrastructure services provided by SA Water subject to the Proclamation.
SA Water	South Australian Water Corporation established by the South Australian Water Corporation Act 1994 (SA)

# 1 Executive summary

The Essential Services Commission (**Commission**) is reviewing whether or not the South Australian water industry third party access regime (**Regime**), established under Part 9A of the Water Industry Act 2012 (**Act**), should continue in operation for five years from 1 July 2019. The Regime commenced on 1 July 2016 and currently applies to specified water and sewerage infrastructure services provided by SA Water.

Under section 86ZR of the Act, the Commission must undertake a review of the water infrastructure and sewerage infrastructure subject to Part 9A and form a view as to whether or not the Regime should continue. The final review and conclusions must be provided to the Minister for Environment and Water (**Minister**) prior to 1 July 2019. The decision to continue or terminate operation of Part 9A of the Act rests with the Minister.

The Regime's statutory objective is to promote the economically efficient use and operation of, and investment in, significant infrastructure to promote competition in upstream and downstream markets.

In essence, the Regime provides a regulatory backstop to help to protect access seekers against the potential misuse of market power by SA Water. The framework supports negotiations conducted both outside and under the Regime by an access seeker and SA Water and, if negotiations fail, provides a process for commercial arbitration.

In November 2018, the Commission released a consultation paper outlining the Regime and its objectives, and the Commission's planned approach to the review.<sup>1</sup> The paper highlighted the absence of formal third party access agreements made under the Regime since July 2016, but noted that voluntary commercial agreements have been struck between SA Water and access seekers. In that context, the consultation paper called for evidence, information and views from stakeholders about the Regime's effectiveness.

## 1.1 Draft finding is to continue the Regime for a further five-year period

The Commission's draft finding is that the Regime should continue for a further five-year period from 1 July 2019. The draft finding is based on:

- ▶ the short period of time during which the Regime has been in operation (since 2016)
- ▶ the low regulatory cost of having a backstop for a regime where access negotiations are likely to be infrequent and specific to the needs of the access seeker, and
- ▶ the fact that, in March 2017, the National Competition Council concluded that the Regime meets the criteria to be certified effective and the relevant Commonwealth Minister certified the Regime as effective.

Nonetheless, submissions from, and discussions with, stakeholders suggest that, in practice, two specific factors may be weakening the effectiveness of the Regime and diminishing the Regime's ability to meet the Regime's statutory objective of promoting the economically efficient use and operation of, and investment in, upstream and downstream markets.

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<sup>1</sup> Commission, '2019 Review of third party access regime: Consultation Paper', November 2018, pp.1-2, available at <https://www.escosa.sa.gov.au/ArticleDocuments/11290/20181102-Water-SAWaterThirdpartyAccessRegimeReview2019-ConsultationPaper.pdf.aspx?Embed=Y>.

- ▶ SA Water is required to use a state-wide retail-minus avoidable cost pricing methodology to calculate access prices for designated infrastructure services unless otherwise approved by the Minister (**Access Pricing Direction**). The Access Pricing Direction must be taken into account by an arbitrator in the event that an access dispute is referred to arbitration. That pricing methodology delivers access prices that are generally close to SA Water's state-wide retail price (which may be different from the efficient local cost of supply) and some stakeholders have suggested that this may deter new entry and competition.
- ▶ There is no formal mechanism for access seekers to apply to have water and sewerage infrastructure covered under the Regime. Nor does the Regime formally set out criteria that the Governor should consider when making a coverage decision (by proclamation).

The Commission sees the two factors raised by stakeholders as potentially worthy of further consideration or review by the South Australian Government. At the same time, the Commission notes that any such assessment would need to consider an overall cost-benefit framework (which would take into account a broader social context in respect to the water industry-specific issues raised by stakeholders). However, those matters are outside of the scope of this review in terms of the role being performed by the Commission under the Act.

## 1.2 Next steps

The Commission invites written submissions on this draft report by 19 April 2019. To facilitate the provision of submissions or address any queries, the Commission would be pleased to meet with stakeholders for a briefing upon request. The Commission intends to release a final report in June 2019.

## 2 The review

The third party access regime that applies to the South Australian water industry (**Regime**) is established under Part 9A of the Water Industry Act 2012 (**Act**) and commenced on 1 July 2016.<sup>2</sup> The Water Industry (Third Party Access) Proclamation 2016 (**Proclamation**) 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.<sup>3</sup> Under Section 86C of the Act, the Essential Services Commission (**Commission**) is appointed as the regulator for the purposes of the Regime.

The Regime finds its origins in *Water for Good*, a 2010 South Australian Government plan outlining proposed water industry reforms.<sup>4</sup> The proposal for a state-based third party access regime was seen as a complement to other reforms outlined in the plan<sup>5</sup> and its regulatory impact was considered in the development and implementation of the Act.<sup>6</sup> Around that same time, the Productivity Commission and the National Competition Council (**NCC**) highlighted the limits of the National Access Regime under Part IIIA of the CCA in providing protection for parties looking to obtain access to urban water infrastructure.<sup>7</sup>

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) (**CCA**) to certify the Regime as effective, for a period of ten years.<sup>8</sup> This means that the alternative pathways for access under Part IIIA of the CCA (declaration or voluntary access undertaking) are not available during the period of certification.

### 2.1 Purpose of review

Under Section 86ZR of the Act, the Commission must undertake a review of water infrastructure and sewerage infrastructure subject to Part 9A of the Act and form a view as to whether or not the Regime should continue from 1 July 2019 for a five-year period. The Commission must provide a report on the review and conclusions reached to the Minister for Environment and Water (**Minister**). The decision to continue or terminate operation of Part 9A rests with the Minister. It should be noted that the Act, in its entirety, is currently being reviewed by the Department for Environment and Water.

The review of the access provisions relates to those parts of SA Water's water and sewerage infrastructure services (such as pipes, treatment plants, pumping stations, storage tanks, surge protection units and valves) necessary for the transport of water and sewerage which have been proclaimed to be covered by the regime.<sup>9</sup> In terms of sewerage infrastructure services, the relevant Proclamation sets out that only certain sections (86F, 86H, 86ZO and 86ZP) of Part 9A of the Act apply (see Appendix A). In contrast, the Regime applies in full to the proclaimed water infrastructure services.

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<sup>2</sup> The Act may be accessed from the Attorney-General's Department website at: <https://www.legislation.sa.gov.au/LZ/C/A/WATER%20INDUSTRY%20ACT%202012/CURRENT/2012.10.AUTH.PDF>.

<sup>3</sup> 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>.

<sup>4</sup> See South Australian Government, 'Water for Good', Final report, June 2010 pp.154-155, available at: <https://www.environment.sa.gov.au/about-us/our-plans>.

<sup>5</sup> See South Australian Government, pp.154-155.

<sup>6</sup> See South Australian Department of Treasury and Finance, 'Access to Water and Sewerage Infrastructure', Report, February 2013, available at [https://www.treasury.sa.gov.au/\\_data/assets/pdf\\_file/0009/36198/access-to-water-and-sewerage-infrastructure-feb-2013-1.pdf](https://www.treasury.sa.gov.au/_data/assets/pdf_file/0009/36198/access-to-water-and-sewerage-infrastructure-feb-2013-1.pdf).

<sup>7</sup> See Productivity Commission, 'Review of National Access Regime', inquiry report, 2014, p. 327, available at <https://www.pc.gov.au/inquiries/completed/access-regime/report/access-regime.pdf>.

<sup>8</sup> Refer the National Competition Council's website at <http://ncc.gov.au/application/application-for-certification-of-the-south-australian-water-infrastructure>.

<sup>9</sup> See section 86ZR of the Act.

The Proclamation further provides that certain water infrastructure services are excluded; that is, those infrastructure services operated by entities other than SA Water, and infrastructure operated by an irrigation operator (if that operator operates the water service infrastructure for the purpose of delivering water for the primary purpose of irrigation) (see Appendix A).<sup>10</sup>

The majority of the water pipeline infrastructure covered under the Regime transport treated water; however, two pipelines transport untreated water and one transports recycled water.<sup>11</sup>

Alongside access to infrastructure services, SA Water offers wholesale water services to customers. This includes the transportation and purchase of water. For many access seekers obtaining water at the right price is the priority, whether through purchasing access and water separately or together. However, the Regime covers access to infrastructure services *only*, not the sale of water, and so the following report has concentrated on access to infrastructure services.

## 2.2 Context and purpose of Regime

SA Water operates the majority of water and sewerage pipeline infrastructure services necessary for the transport of water and sewage in South Australia. In this position, it has commercial incentives to negotiate terms of access to the services provided by the infrastructure. Indeed, more than 140 individual commercial access agreements for the transportation of treated water have been negotiated since the late 1990s, five of which have been agreed since July 2016.<sup>12</sup> Many of these agreements have been part of large negotiated schemes that source access to water infrastructure. A small number of voluntary contracts for the transportation of a large quantity of untreated water were arranged in the early 2000s.

Over the past two decades, demand for access to SA Water's bulk water transport services has been most evident from firms in the agricultural sector. Developments in commodity markets, agricultural productivity and demand side substitution (eg supply through storage options, piping from nearby water sources and micro-desalination plants<sup>13</sup>) can have a material effect on the demand for and utilisation of infrastructure services.

In addition, and importantly, end-user demand from households accounts for a sizeable share of the utilisation of these pipeline infrastructure services. The outlook for growth in household demand remains modest, on the back of forecasts for population growth and economic growth in South Australia.<sup>14</sup>

Within this context, the Regime establishes a negotiate-arbitrate framework that provides a fallback regulatory option to improve access seekers' position in negotiations with SA Water for access to declared infrastructure services.<sup>15</sup> The availability of that regulatory option may reduce SA Water's capacity to dictate terms and thereby allow parties to negotiate on a more equal footing. This can support voluntary commercial access agreements that are mutually beneficial relative to the case where such a regulatory option is not in place.

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<sup>10</sup> See Proclamation.

<sup>11</sup> For a full list of water pipelines operated by SA Water covered under the Regime, see Appendix A.

<sup>12</sup> SA Water, '2019 Review of Water Third Party Access Regime', submission, December 2018, pp.1-2, available at: <https://www.escosa.sa.gov.au/ArticleDocuments/11341/20190117-Water-ThirdPartyAccessRegimeReview2019Submission-SAWater.pdf.aspx?Embed=Y>.

<sup>13</sup> See Coorong District Council and Coorong Security Advisory Group, '2019 review of third party access regime', submission, December 2018, pp.2-3, available at: <https://www.escosa.sa.gov.au/ArticleDocuments/11341/20190117-Water-ThirdPartyAccessRegimeReview2019Submission-Coorong.pdf.aspx?Embed=Y>.

<sup>14</sup> See NCC, 'South Australian Water Access Regime', application for certification under section 44M of the Competition and Consumer Act, Final Recommendation, 22 March 2017, p.18, available at [http://ncc.gov.au/images/uploads/NCC\\_Final\\_recommendation\\_-\\_certification\\_of\\_SA\\_water\\_access\\_regime\\_-\\_22\\_....pdf](http://ncc.gov.au/images/uploads/NCC_Final_recommendation_-_certification_of_SA_water_access_regime_-_22_....pdf).

<sup>15</sup> Commonwealth certification can further reinforce regulatory certainty – see Productivity Commission, Review of National Access Regime, p.59. (For information on certification of the Regime see Appendix B.)

To the extent that a regulated option is available to access seekers and is effective in practice, the Regime can encourage competition in other markets (such as promoting trade in water entitlements and new sources of supply) and promote economic activity, particularly in industries reliant on water as a key input.<sup>16</sup> This is consistent with the statutory objectives of the Act to promote the economically efficient use and operation of, and investment in, significant infrastructure so as to promote competition in upstream and downstream markets.<sup>17</sup> At the same time, the Regime maintains protections for the security of the state's water supply, and the health and safety of South Australians.<sup>18</sup>

Access prices for designated infrastructure services are determined by SA Water by a state-wide retail-minus avoidable cost pricing methodology, unless approved by the Minister (see Box 1).

### Box 1: Prices for access to infrastructure services

The basis for negotiating access prices is a combination of two distinct directions: state-wide retail pricing and the retail-minus avoidable cost pricing methodology.

- ▶ State-wide retail pricing policy refers to the direction that drinking water prices be the same across all metropolitan and regional areas.
- ▶ The retail-minus avoidable cost pricing methodology calculates access prices as the incumbent's final product price less the costs it would avoid by providing access.

On 24 June 2016, the then Minister for Water and the River Murray directed SA Water under the Public Corporations Act 1993 (SA) to use a state-wide retail-minus avoidable cost pricing methodology to determine access prices for all infrastructure services unless directed otherwise by the Minister (**Access Pricing Direction**).<sup>19</sup>

- ▶ Access prices are determined by SA Water's state-wide retail fees and charges per customer minus SA Water's avoidable costs for designated services, plus any facilitation costs to provide the services.
- ▶ Avoidable costs mean the costs in the long term that SA Water would otherwise incur in the provision of retail services to the customer.
- ▶ Designated services means all infrastructure services using SA Water's infrastructure (not just the infrastructure subject to the Access Regime) except assets used solely for the transportation of recycled water.

For example, under the Access Pricing Direction, a new entrant wishing to access SA Water's local treated water pipelines would be charged the state-wide retail water price minus the avoidable costs of treatment, transportation and customer service.<sup>20</sup> This means the access price is linked to SA Water's cost of providing state-wide infrastructure. The policy is intended to protect against circumstances in which private providers gain access to low-cost sections of SA Water's network, leaving SA Water to serve high-cost sections of the network. That may create upward price pressure for SA Water's remaining customers.<sup>21</sup>

<sup>16</sup> See Parliamentary Hansard Transcript, 16 June 2016, available at: <https://hansardpublic.parliament.sa.gov.au/Pages/HansardResult.aspx#/docid/HANSARD-10-15914>.

<sup>17</sup> See section 3(g) of the Act.

<sup>18</sup> See Parliamentary Hansard Transcript.

<sup>19</sup> See *Direction to the South Australian Water Corporation Pursuant to Section 6 of the Public Corporations Act 1993*, 24 June 2016, available at <https://www.escosa.sa.gov.au/ArticleDocuments/604/20160701-Water-ThirdPartyAccess-SignedDirection.pdf.aspx?Embed=Y>.

<sup>20</sup> In practice, water treatment often occurs early in the supply chain and, therefore, its costs may not be avoidable.

<sup>21</sup> See Parliamentary Hansard Transcript.

## 2.3 Submissions

In November 2018, the Commission released a consultation paper outlining the Regime and the Commission's intended approach for assessing whether or not the Regime should continue for a five-year period from 1 July 2019.<sup>22</sup> The paper highlighted the absence of formal agreements under the Regime since its introduction.

In that context, the consultation paper called for submissions from stakeholders, in particular parties that had attempted or considered use of the Regime, or had sought access under voluntary commercial negotiations. It posed questions to stakeholders, requesting information about barriers to negotiation, scope and coverage of infrastructure services subject to the Regime and implications of the retail-minus pricing methodology.

Submissions to the review were received from:

- ▶ SA Water
- ▶ Business SA, and
- ▶ Coorong District Council and Coorong Security Advisory Group.

In addition to the three written submissions, the Commission met with a number of stakeholders, including some parties that have sought access to infrastructure outside of the Regime but did not proceed under the Regime and some that have voluntary commercial agreements outside of the Regime.

## 2.4 Approach taken

The Commission is assessing whether or not the Regime should continue in operation by:

- ▶ reviewing the rationale for having a regulatory backstop, by drawing on theory together with evidence from submissions and the NCC about the potential for the misuse of market power, and
- ▶ reviewing the Regime's effectiveness, by examining outcomes in and associated with voluntary commercial negotiations outside of the Regime, and by investigating the level of protection available to access seekers under Part IIIA of the CCA.

The review also draws on evidence from stakeholders about the factors that may weaken the Regime's ability to act as a regulatory backstop and promote the economically efficient use and operation of, and investment in, upstream and downstream markets. The approach taken has been used in the past by the Commission to review comparable access frameworks such as the South Australian intrastate rail access regime.<sup>23, 24</sup>

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<sup>22</sup> See Commission, Review of water third party access regime, 2018 p. 2.

<sup>23</sup> See NCC, p. 15.

<sup>24</sup> See Commission, 'South Australian Rail Access Regime Review', Final report, 2015, available at <https://www.escosa.sa.gov.au/ArticleDocuments/358/20150907-SARailAccessRegimeReview-FinalReport.pdf.aspx?Embed=Y>.

### 3 The Regime should continue in operation

- ▶ Draft recommendation: the Minister should extend Part 9A of the Act from 1 July 2019 for five years. The Regime provides some benefit, as a backstop for private negotiations to obtain access, and at only a limited regulatory cost.
- ▶ Draft recommendation: some stakeholders have suggested that the effectiveness of the Regime may be weakened by the use of the Access Pricing Direction (in combination with the existing state-wide pricing policy) and a lack of a mechanism (and clear established criteria) for access seekers to apply to have infrastructure services declared. While not going directly to the fundamental structure of the Regime, those two factors are potentially worthy of consideration for review by the Government, noting that any assessment should fully consider the costs and benefits of an alternative access pricing methodology and the issue of state-wide pricing.

The Commission's assessment of the continuation of Part 9A of the Act is organised into four sections. First, it considers if a regulatory backstop is necessary to protect parties seeking access to SA Water's infrastructure services. Second, it examines commercial outcomes (where available) before and after introduction of the Regime to assess the benefits and costs of having the regulatory backstop in operation. Third, it highlights the limited level of protection available to access seekers under the National Access Regime. Fourth, it draws attention to factors that may be weakening the effectiveness of the Regime.

#### 3.1 Is a regulatory backstop necessary?

An effective regulatory backstop can incentivise commercial negotiations between an access seeker and SA Water. In line with this, some submissions recognised the value in having an access framework in place.<sup>25</sup> Further, the scope of SA Water's infrastructure services met the requirements of clause 6(3)(a) of the Competition Principles Agreement (CPA)<sup>26</sup> as assessed by the NCC in 2017.<sup>27</sup>

There are three characteristics indicating that, in relation to the infrastructure services under the Proclamation, SA Water may have the ability to use market power for an improper purpose.

- ▶ The water and sewerage infrastructure assets covered under the Regime are considered to have natural monopoly characteristics (ie high fixed costs and low variable costs<sup>28,29</sup>). A recent assessment by the NCC suggests the infrastructure services covered by the Regime are natural monopoly services, as it would not be profitable to duplicate the infrastructure assets in question.<sup>30</sup>
- ▶ Some access seekers are small scale and may therefore have limited countervailing bargaining power.<sup>31</sup>
- ▶ Some submissions note that the threat from actual and potential substitutes appears to be of limited scale and prevalence.<sup>32</sup>

<sup>25</sup> See Business SA, submission, p. 1, available at <https://www.escosa.sa.gov.au/ArticleDocuments/11341/20190117-Water-ThirdPartyAccessRegimeReview2019Submission-BusinessSA.pdf.aspx?Embed=Y>, and SA Water, p.1.

<sup>26</sup> See CPA, 1995, p. 7, available at <https://www.coag.gov.au/sites/default/files/agreements/competition-principles-agreement-amended-2007.pdf>.

<sup>27</sup> See NCC, p.10.

<sup>28</sup> See Productivity Commission, Australia's Urban Water Sector, p. 73.

<sup>29</sup> See Productivity Commission, Review of National Access Regime, p. 74.

<sup>30</sup> See NCC, p.17.

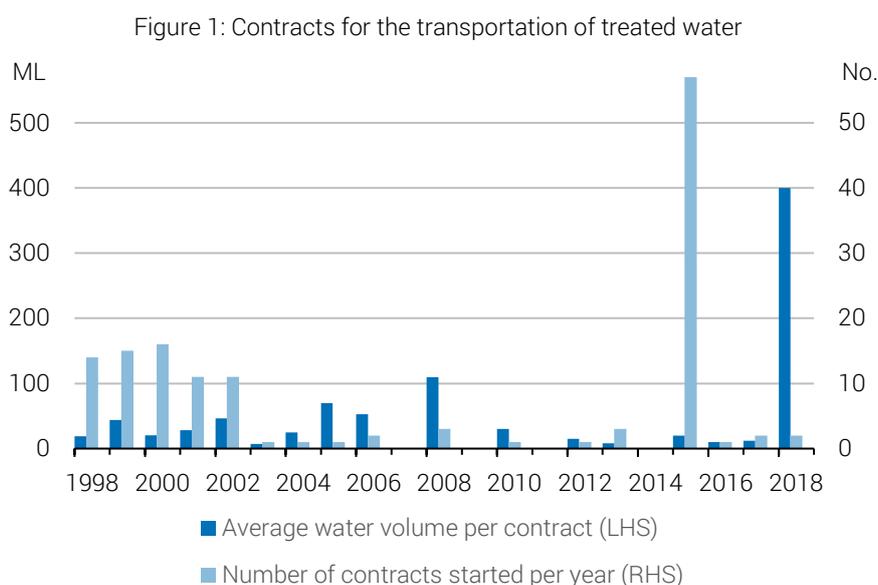
<sup>31</sup> See Coorong District Council and Coorong Security Advisory Group, pp. 2-3.

<sup>32</sup> See Coorong District Council and Coorong Security Advisory Group, p. 2.

These characteristics can create high barriers to entry and allow for the ability to set access prices regardless of the actual cost. A monopolist has the potential to use market power for improper purposes, such as by preventing access to competitors and customers, setting prices in excess of the cost of supply, and reducing service quality.

### 3.2 Limited evidence from outcomes of voluntary commercial agreements

The availability of the regulated option could, in principle, support private negotiations outside of the Regime as compared to a counterfactual case under which no Regime is in place. At this stage, however, the number and volume of commercial agreements are inconclusive in demonstrating the value of a backstop. The majority of water transportation agreements have been part of a small number of large schemes that were commercially negotiated with SA Water. New agreements have tended to reflect additional customers signing up to these schemes (Figure 1).



In terms of the regulatory costs under the Regime, SA Water reports that start-up and ongoing administrative costs involved with the Regime have been relatively low.<sup>33</sup> No information has been provided to indicate increased administrative costs associated with voluntary commercial access contracts since the introduction of the Regime.<sup>34</sup>

### 3.3 Is a state-based third party access framework suitable?

Another way to consider the effectiveness of the Regime is to consider alternative policies to address the potential for the misuse of market power. For instance, if Part 9A of the Act were not renewed by the Minister in June 2019, or if there were ‘substantial modifications’ made to existing infrastructure (in which case certification may no longer apply<sup>35</sup>), the National Access Regime would provide some level of regulatory protection for access seekers.

Overall, the Regime provides some benefit, as a backstop for private negotiations, and at only a limited regulatory cost, whereas reliance on the National Access Regime is unlikely to generate more benefit and involve greater costs, given the national significance test and the risk to timeliness of applications.

A further benefit of a state-based Regime is that it can allow coverage and scope to be adjusted to suit local economic circumstances.<sup>36</sup> It may also improve the timeliness and consistency of regulatory

<sup>33</sup> Based on confidential information provided by SA Water to the Commission.

<sup>34</sup> Based on confidential information provided by SA Water to the Commission.

<sup>35</sup> See NCC, p.16.

<sup>36</sup> See South Australian Department of Treasury and Finance, pp. 2-3.

decisions by using local expertise: experience nationally and overseas has shown that access issues can be highly complex in nature, involving detailed examination of costs throughout complex networks, in which local knowledge can be highly important.<sup>37</sup> Together, these advantages can support access seekers' confidence in and use of the regulated option provided by the Regime. At the same time, as noted above, the regulatory costs appear low.<sup>38</sup>

One disadvantage of the Regime is that it does not provide a legislative or formal regulatory process under which an access seeker can apply to have services covered by the Regime, nor does it set out the criteria which would need to be addressed or considered for the purposes of having infrastructure services proclaimed.<sup>39</sup>

Were Part 9A of the Act be allowed to expire, access to infrastructure services could be available under the National Access Regime, through declaration of services by the relevant Commonwealth Minister or an access undertaking submitted by the service provider and approved by the Australian Competition and Consumer Commission (ACCC). While access under these pathways provide a clear process and criteria,<sup>40</sup> the declaration process places the onus on the access seeker to demonstrate that the infrastructure services sought are 'nationally significant'.<sup>41</sup> In contrast, under a state-based framework the criteria for declaration relates to its significance to the state economy.<sup>42</sup>

### 3.4 Potential impediments to the effectiveness of the Regime

Stakeholders claim two factors could be weakening the Regime's effectiveness:

- ▶ the Access Pricing Direction,<sup>43</sup> and
- ▶ the limited criteria and mechanism to obtain declaration for water infrastructure services.<sup>44</sup>

#### 3.4.1 Access prices

As discussed in section 2.2, the Regime is intended to promote the economically efficient use and operation of, and investment in, significant infrastructure to promote competition in upstream and downstream markets. Access prices can play an important role in furthering that objective.

The retail-minus avoidable cost approach to access pricing is directly linked to SA Water's state-wide retail pricing methodology. State-wide pricing is a Government policy position and not a regulatory consideration.

However, a result of that link is that access prices may not reflect the actual avoidable cost to SA Water in each location, noting that locational prices may be higher or lower than state-wide prices depending on the location. Concerns raised by stakeholders about the cost of obtaining access to SA Water's infrastructure services appear to relate to the presence of state-wide pricing, rather than being critical of the retail-minus approach as such.<sup>45</sup> It is in regions where the local infrastructure costs are below the state-wide infrastructure cost that efficient utilisation of the local infrastructure may be disincentivised,

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<sup>37</sup> See Commission, 'Submission by ESCOSA on The Report Prepared by the South Australian Department of Treasury and Finance Entitled "Access to Water and Sewerage Infrastructure"', 2013, pp. 9-10, available at [https://www.treasury.sa.gov.au/\\_data/assets/pdf\\_file/0003/36192/130315-0-submission-to-access-report\\_final.pdf](https://www.treasury.sa.gov.au/_data/assets/pdf_file/0003/36192/130315-0-submission-to-access-report_final.pdf).

<sup>38</sup> Based on confidential information provided by SA Water to the Commission.

<sup>39</sup> See NCC, pp.15-16.

<sup>40</sup> See Productivity Commission, Review of National Access Regime, p.58.

<sup>41</sup> See CPA, p. 7.

<sup>42</sup> See Council of Australian Governments (COAG), 'Intergovernmental agreement on competition and productivity-enhancing reforms', 2007, p.19, available at <https://www.coag.gov.au/sites/default/files/agreements/iga-competition-productivity-enhancing-reforms.docx>.

<sup>43</sup> Based on Business SA, p.1. This was also raised with the Commission in private discussions with stakeholders.

<sup>44</sup> Based on SA Water, pp.1-2, and NCC, p.10.

<sup>45</sup> See Coorong District Council and Coorong Security Advisory Group, pp.2-3. This was also raised with the Commission in private discussions with stakeholders.

but this is mainly due to state-wide retail pricing. There are also regions where the local infrastructure costs may be higher than the state-wide infrastructure cost.

The Commission notes that retail-minus is a commonly recognised basis for setting access prices and was accepted by the NCC in its assessment of the effectiveness of the Access Regime when recommending its certification.<sup>46</sup>

While there may be ways to set access prices other than through a retail-minus approach (eg by directly calculating costs incurred in providing access), any such a change must be considered in light of the presence of state-wide retail pricing and the policy objectives that underpin it. The economic objective of access pricing forms one part of the suite of objectives (including social objectives) that state-wide pricing is intended to deliver. It is for this reason that the Commission would caution against any review of the retail-minus approach to setting access prices, without giving due consideration to all aspects of SA Water's retail prices. Any such broader review of prices is outside the scope of this current review.

### **3.4.2 Limited criteria and mechanism to obtain declaration for infrastructure services**

As noted in section 3.3, there is no formal mechanism for access seekers to apply to have alternative infrastructure services covered, nor are there clear, documented criteria governing the proclamation of services so as to bring them within the Regime's remit.<sup>47</sup> The Commission notes that, in making a proclamation, the Governor acts on the advice of the Executive Council, which, in turn, has access to independent advice and reporting from the Commission,<sup>48</sup> and the criteria set out in the CPA and Council of Australian Governments (COAG) agreements (which provide guidance on issues of coverage).<sup>49</sup> Nonetheless, the Regime could be enhanced through the introduction of a formal mechanism, such as a process for an access undertaking, to allow access applications.

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<sup>46</sup> See NCC, pp. 36-39.

<sup>47</sup> See NCC, p.10.

<sup>48</sup> See NCC, p.10.

<sup>49</sup> See CPA, p.10, and COAG, p. 19.

## 4 Conclusion

The Regime established under Part 9A of the Act can, in principle, provide a regulatory backstop to protect access seekers against the potential misuse of market power by SA Water. This important factor suggests that there is overall benefit in the continuation of the Regime for a further five-year period.

As a matter of practice, however, some stakeholders have suggested that the effectiveness of the Regime may be weakened by the use of the Access Pricing Direction (in combination with the existing state-wide pricing policy) and a lack of a mechanism (and clear established criteria) for access seekers to apply to have infrastructure services declared. While not going directly to the fundamental structure of the Regime, those two factors are potentially worthy of consideration for review by the Government, noting that any assessment should fully consider the costs and benefits of an alternative access pricing methodology and the issue of state-wide pricing.

Overall, given the short time period in which the Regime has been in operation, the low regulatory costs of continuing the Regime, and the fact that the NCC has concluded that the Regime meets the criteria to be certified effective and the relevant Commonwealth Minister certified the Regime as effective in March 2017, the Commission's draft finding is that the regulatory backstop provided by the Regime should continue for a further five-year period from 1 July 2019.

## 5 Next steps

The Commission seeks stakeholder views on this draft report by Friday 19 April 2019. The inside cover of this report explains how to make a submission.

The Commission would also be pleased to meet informally with stakeholders, either individually or with representative organisations, to discuss the draft decision. If you or your organisation wish to meet with Commission staff, please use the contact details on the inside cover of this draft report.

The Commission aims to publish its final report on the review of the water third party access regime in June 2019.

## 6 Appendix A: background on Regime

The Regime is established under Part 9A of the Act, and the Proclamation issued under the Act declares SA Water to be the 'regulated operator' for the purposes of the Regime and prescribes the particular services that are covered by the Regime.<sup>50</sup>

Key features of the Regime and the roles and responsibilities of the Minister, Commission, SA Water and the access seeker are explained below.

### Roles of the Government and Ministers

The Government and the Minister for Environment and Water has overall roles to:

- ▶ determine 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
- ▶ 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.

### Role of 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.

### SA Water's obligations

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 seeker's 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

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<sup>50</sup> See Commission, '2019 Review of third party access regime', pp. 3-10.

- ▶ 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 is properly allowed.

### **Infrastructure and infrastructure services covered under the Regime**

The Regime applies in full 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
- ▶ Tailem Bend to Keith, and
- ▶ Glenelg to Adelaide.

The Regime also 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,
- ▶ provision of information provided on a non-discriminatory basis,
- ▶ provision of copies of access contracts to be supplied to the Commission, and
- ▶ SA Water must supply specified information to the Commission.

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.

### **Exclusions from the regime**

The Proclamation further sets out the services and infrastructure that are excluded from the Regime's scope. These include:

- ▶ 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.

## 7 Appendix B: background on certification

The Regime has been certified by the NCC. Certification provides a formal link between Part IIIA of the CCA and a state-based access regime. This serves to improve consistency and reduce regulatory duplication, and therefore promote overall regulatory certainty.<sup>51</sup> It does this by removing alternative pathways for access under Part IIIA of the CCA during the period of certification.

On 11 November 2016, the NCC received an application from the South Australian Government for a recommendation pursuant to section 44M(2) of the CCA that the Regime be certified as an effective access regime. The NCC considered the application and undertook its own inquiries and research into the Regime. On May 22 2017, the NCC recommended that the Regime met requirements for certification.<sup>52</sup>

On 22 May 2017, the then Commonwealth Treasurer, the Hon. Scott Morrison MP, made a decision under Part IIIA of the CCA to certify the Regime as effective, for a period of ten years.<sup>53</sup>

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<sup>51</sup> See Productivity Commission, National Access Regime, p.59.

<sup>52</sup> See NCC, pp.6-7.

<sup>53</sup> Refer the National Competition Council's website at <http://ncc.gov.au/application/application-for-certification-of-the-south-australian-water-infrastructure> (accessed 3 February 2019).



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