The NSW Water Industry Access Regime

A guide to declaration of infrastructure under the *Water Industry Competition Act 2006*

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Acknowledgements

IPART wishes to acknowledge the National Competition Council as this Guide has partly drawn on its Guide to Part IIIA of the *Trade Practices Act 1974 (Cth)* (2002) ("**TPA**").

IPART would also like to acknowledge and thank Mallesons Stephen Jaques for the assistance provided by them in drafting this guide to declaration of infrastructure under the *Water Industry Competition Act 2006 (NSW)* ("**Guide**").

Foreword

Introduction

The Independent Pricing and Regulatory Tribunal ("**IPART**") has developed this Guide to the declaration criteria set out in the *Water Industry Competition Act 2006 (NSW)* ("**Act**") to assist parties with preparing applications for:

- coverage declaration;
- binding non-coverage declaration; and
- revocation of coverage declaration.

This Guide also seeks to help interested parties to better understand and participate in water industry access issues in New South Wales.

The views expressed in this Guide will continue to evolve and are neither definitive nor binding, as each application for declaration may raise unique issues.

This Guide does not address access undertakings.

The declaration criteria and application templates

This Guide contains an overview of IPART's approach to each of the declaration criteria set out in section 23 of the Act and complements IPART's:

- application template for coverage declaration;
- application template for revocation of coverage declaration; and
- application template for binding non-coverage declaration.

These application templates are available on IPART's website.

While there are some differences in the drafting of declaration criteria, to the extent it is appropriate to do so, IPART has had regard to and drawn on judicial and regulatory consideration of the corresponding declaration criteria under Part IIIA of the TPA and other relevant access regimes such as the National Gas Acts.

Structure of this Guide

This Guide sets out an overview of the Act, what services may be declared and IPART's views as to the operation of each declaration criterion.

A glossary of terms and abbreviations used in this Guide is set out in Section 13.

There is a series of attachments at the end of this Guide as follows:

Attachment A: ***Timeline***

This is a timeline for the application processes, stating the key milestones of the period during which applications are considered by IPART.

Attachment B: Comparison of other access regimes

This annexure provides a comparison of the various sets of declaration criteria of access regulation legislation across Australia.

Attachments C, D, E and F: Case Studies

These case studies lay out four important judicial decisions in respect of access to infrastructure under Part IIIA of the TPA and the Gas Code:

- *Re Application by Services Sydney Pty Ltd* [2005] ACOMPT 7;
- *Duke Eastern Gas Pipeline Pty Ltd* (2001) ATPR 41–821; and
- *BHP Billiton Iron Ore v National Competition Council* [2007] FCAFC 157; and
- *Application of Virgin Blue Airlines Ltd* (2006) ATPR 42-092

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1 Water Industry Competition Act 2006

1.1 Introduction

One of the purposes of the Act is to encourage competition in relation to the supply of water and the provision of sewerage services and to facilitate the development of infrastructure for the production and reticulation of recycled water.

1.2 IPART's role

IPART is established by the *Independent Pricing and Regulatory Tribunal Act 1992* (NSW) ("IPART Act") which confers functions on IPART in relation to pricing, industry and competition; and for other purposes.

In addition, IPART has specific functions in respect of the Act. Predominantly, these are set out in Part 8 of the Act.

IPART has licence auditing and regulatory functions pursuant to Part 8 Division 1 and 2 of the Act. These functions include reporting obligations to the Minister and powers to direct licensing. Pursuant to Part 8 Division 3, IPART may conduct investigations and issue guidelines that are consistent with its functions under the Act.

1.3 The licensing regime

Part 2 of the Act sets out a licensing regime for network operators and retail suppliers. The scheme is intended to stimulate private sector involvement in the supply of water and the provision of sewerage services.

In considering whether or not to grant a licence, the designated Minister must take into account such factors as the public interest, capacity of the applicant and public health.

The licensing regime provides for the imposition of conditions on licensee activities, penalising breaches and suspending or cancelling licences following a contravention of the Act.

1.4 The access regime

The access regime is established by Part 3 of the Act and is the focus of this Guide. The access regime establishes a scheme to promote the economically efficient use and operation of, and investment in, significant water industry infrastructure, thereby promoting effective competition in upstream or downstream markets.

1.5 Service providers and sewer mining

Part 4 of the Act sets out a process for resolving disputes between service providers and sewer miners. If a dispute arises between a service provider and a sewer miners in relation to a relevant agreement or determination then either party to the dispute may apply to IPART for the dispute to be determined by arbitration.

1.6 Retail customer interests

Part 5 of the Act sets out procedures for resolving disputes between small retail customers and licensed retail suppliers of water, water services or sewerage services.

Customers are given a right to have a retail supplier's decision reviewed, and the Minister is empowered to develop an industry ombudsman scheme. The Act allows the Minister to regulate prices and impose obligations in the case of a monopoly supplier of water or related services in a specified area.

Procedures are set out to ensure that the failure of a licensed retail supplier is swiftly addressed.

1.7 Infrastructure

Part 6 has provisions relating to the construction, placement, alteration or removal of water industry infrastructure. This is complemented by Part 8, which creates a series of statutory offences for the damage or misuse of such infrastructure.

1.8 Offences and powers of inspectors

Part 7 Division 1 of the Act sets out offences under the Act, including offences relating to the exposure of underground pipes, interference with meters and infrastructure, unauthorised connections or increase in the capacity of connections, discharge into drains and sewers, unauthorised use of water and unlicensed plumbing and drainage work.

Part 7 Division 2 provides for the appointment of inspectors by the Minister and provides powers of inspection including the use of reasonable force.

2 Part 3 of the Act and the declaration criteria

2.1 Purpose

Part 3 provides for an access regime to services provided by water industry infrastructure where access promotes competition in upstream or downstream markets.

The focus of this Guide is the declaration criteria in Part 3 of the Act.

2.2 There are two access pathways

Part 3 sets out two pathways as follows:

- coverage declaration of water industry infrastructure services under Part 3 Division 2; and
- voluntary undertakings by a service provider under Part 3 Division 5.

If either of these access pathways apply, an access seeker obtains a right to negotiate access to services with binding arbitration available for disputes relating to access.

A binding non-coverage declaration is also available for proposed infrastructure, existing infrastructure that is not currently used or existing infrastructure that is currently used otherwise than for the production, treatment, filtration, storage, conveyance or reticulation of water or sewage.

This Guide does not address voluntary access undertakings.

2.3 The declaration criteria

The declaration criteria are set out in section 23 of the Act as follows:

> *"(a) that the infrastructure is of State significance, having regard to its nature and extent and its importance to the State economy,*
>
> *(b) that it would not be economically feasible to duplicate the infrastructure,*
>
> *(c) that access (or an increase in access) to the service by third parties is necessary to promote a material increase in competition in an upstream or downstream market,*
>
> *(d) that the safe use of the infrastructure by access seekers can be ensured at an economically feasible cost and, if there is a safety requirement, that appropriate regulatory arrangements exist,*
>
> *(e) that access (or an increase in access) to the service would not be contrary to the public interest."*

The declaration criteria are used by IPART in the course of its obligations to consider and report to the Minister in respect of applications under Part 3 of the Act for coverage declarations, non-binding coverage declarations and revocation of coverage declarations.

2.4 Coverage declaration - all of the declaration criteria must be met

Section 26 of the Act provides that the Minister may only declare a service under this Division if all of the declaration criteria are satisfied and the service is not the subject of a binding non-coverage declaration or an access undertaking.

Any person may make an application for coverage declaration to IPART in respect of infrastructure services under section 24 of the Act. However, coverage declaration can only be made for:

- certain types of water industry infrastructure - see section 4 of the Guide; and
- certain types of services provided by means of that infrastructure - see section 5 of the Guide.

IPART will consider the application and whether the declaration criteria are satisfied. It will then make a recommendation to the Minister in respect of the application in accordance with section 25 of the Act.

2.5 What happens if coverage declaration occurs?

If declaration occurs, service providers and access seekers acquire a legal right pursuant to Part 3 Division 6 to:

- negotiate access to the service with the service provider; and
- if necessary, have access disputes determined through arbitration.

Coverage declaration does not entitle an access seeker to access. However, it is an important step because it provides for an enforceable right to dispute resolution with IPART or an IPART nominated arbitrator if negotiation fails. IPART or this nominated arbitrator may, among other things, require the provision of access and specify the relevant terms and conditions of this access.

2.6 Revocation of coverage declaration - any of the declaration criteria are not met

Pursuant to section 30 of the Act, the Minister may revoke coverage declaration where any of the declaration criteria are not met.

A services provider may make an application for revocation of coverage declaration to IPART under section 28 of the Act.

IPART will consider the application and make a recommendation to the Minister in respect of the application in accordance with section 29.

2.7 Binding non coverage declaration - any of the declaration criteria are not met

Binding non-coverage declaration is available to service providers under Part 3 Division 4 of the Act. Section 34 provides that the Minister may only declare a service under this Division if any of the declaration criteria are not

satisfied and the service is not the subject of a coverage declaration or an access undertaking.

Section 32 provides that applications for a binding non-coverage declaration may only be made by or on behalf of the service provider for that service. If granted, those infrastructure services are immune from declaration.

Section 31 provides that binding non-coverage declaration is only available in respect of infrastructure services to be provided by:

- proposed water industry infrastructure, being infrastructure (other than a minor extension to existing infrastructure) that is not currently constructed; or
- existing infrastructure that is not currently used; or
- existing infrastructure that is currently used otherwise than for the production, treatment, filtration, storage, conveyance or reticulation of water or sewage,

but does not apply to infrastructure services provided by existing water industry infrastructure.

Applications under this division may not be made after the water industry infrastructure by means of which the service is to be provided has been commissioned.

IPART will consider the application and make a recommendation to the Minister in accordance with section 33 of the Act.

Section 37 provides that the Minister may revoke a binding non-coverage declaration if:

- the service provider for the service to which the declaration relates requests the Minister to revoke the declaration; or
- if the application for the declaration contained false or misleading information or failed to contain information that it was required to contain.

2.8 Frivolous or vexatious application

Applications for coverage declarations, revocation of coverage declaration and binding non-coverage declarations which are determined by IPART to be either frivolous or vexatious will not be considered (with the Minister's consent) by IPART.

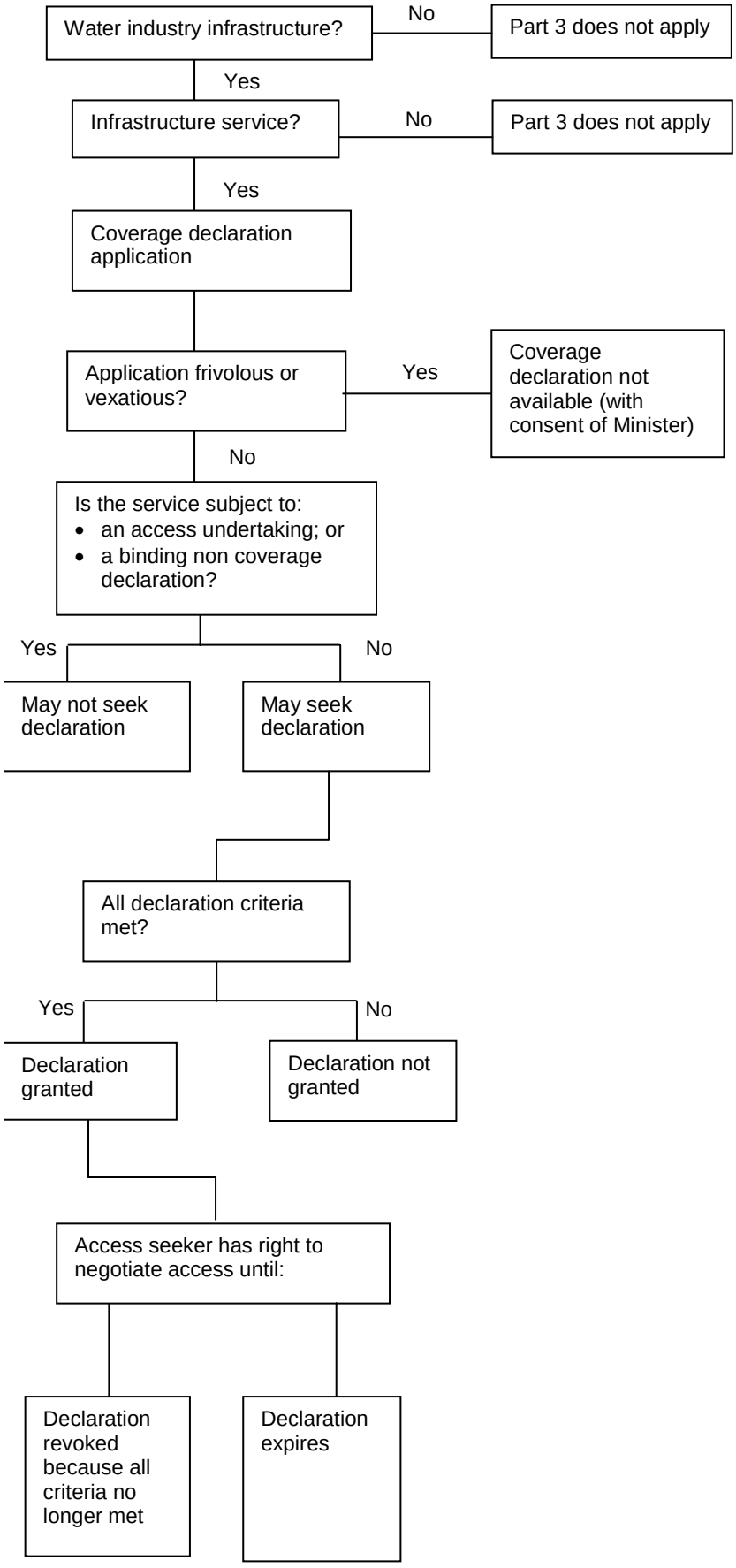
2.9 Timelines

A timeline is set out at Attachment A to this Guide for applications for coverage declarations, revocation of coverage declaration and binding non-coverage declarations, stating the key milestones of the period during which applications are considered by IPART.

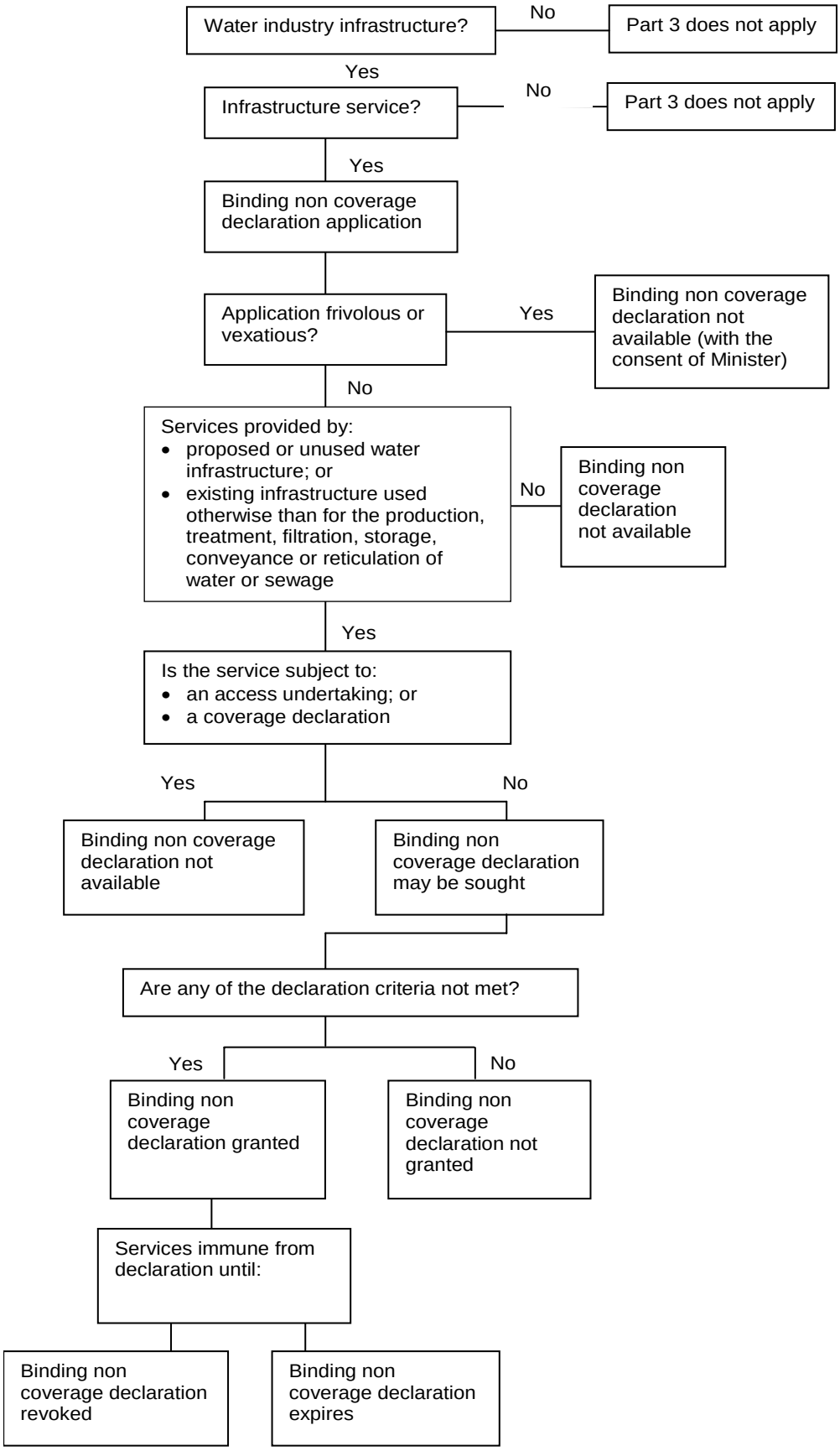
2.10 Application fee

A fee of $2,500 must accompany each application.

2.11 Coverage declaration flow chart



2.12 Binding non coverage declaration flow chart



3 Factors IPART may have regard to in considering applications

3.1 Introduction

IPART may have regard to the matters set out below in determining applications for coverage declaration, revocation of coverage declaration and binding non-coverage declaration.

3.2 The object underlying Part 3 of the Act

IPART has regard to the object of Part 3, which is set out in section 21 of the Act as follows:

> *"The object of this Part is 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 or downstream markets."*

3.3 The Trade Practices Act 1974 (Cth) ("TPA")

IPART may have regard to the relevant recommendations and decisions of the National Competition Council, Australian Competition Tribunal ("ACT"), the Federal Court of Australia and the High Court of Australia on the declaration criteria of section 44G(2) and 44H(4) of the TPA, especially those relating to water industry infrastructure.

While there are some variations, the words of the coverage criteria in section 44G(2) and 44H(4) of the TPA are the substantially similar to the words of the declaration criteria in section 23 of the Act.

3.4 The National Gas Acts

This Guide refers to declaration decisions in relation to gas pipelines pursuant to the declaration criteria of the *National Third Party Access Code for Natural Gas Pipeline Systems* ("**Gas Code")**.

The states and territories of Australia, excepting Western Australia, have enacted legislation to enshrine the Gas Code in law ("**National Gas Acts**"). There are no substantive differences between the declaration criteria of the Gas Code and the declaration criteria of each National Gas Act.

Consequently, IPART may have regard to the relevant decisions of the ACT in relation to applications for coverage of gas pipelines under any National Gas Act and previous decisions under the Gas Code.

A table comparing the various access regimes is set out at **Attachment B**.

4 Water industry infrastructure

4.1 Introduction

The declaration process in Part 3 provides for access to the services of water industry infrastructure (or part of such infrastructure) rather than the infrastructure itself. The starting point for applying each of the declaration criteria is to identify the water industry infrastructure and the infrastructure service provided by means of the water industry infrastructure.

Services that may be subject to declaration and those that are expressly excluded are discussed further in Section 5.

4.2 The infrastructure providing the service

The Act defines the various relevant types of infrastructure as follows:

> "***water industry infrastructure*** *means water infrastructure or sewerage infrastructure.*
>
> ***sewerage infrastructure*** *means any infrastructure that is, or is to be, used for the treatment, storage, conveyance or reticulation of sewage, including any outfall pipe or other work that stores or conveys water leaving the infrastructure, but does not include any pipe, fitting or apparatus that is situated upstream of a customer's connection point to a sewer main.*
>
> ***water infrastructure*** *means any infrastructure that is, or is to be, used for the production, treatment, filtration, storage, conveyance or reticulation of water, but does not include:*
>
> *(a) any pipe, fitting or apparatus that is situated downstream of a customer's connection point to a water main, or*
>
> *(b) any pipe, fitting or apparatus that is situated upstream of a customer's connection point to a storm water drain."*

4.3 Location of water industry infrastructure

Section 22 provides that Part 3 only applies to water industry infrastructure that is situated in, on or over land that is a scheduled area described in Schedule 1 of the Act. At the time of writing this Guide, the scheduled areas are:

- the area of operations of the Sydney Water Corporation, as referred to in section 10 of the *Sydney Water Act 1994*; and
- the area of operations of the Hunter Water Corporation, as referred to in section 16 of the *Hunter Water Act 1991*.

Therefore, an application for declaration can only be made in respect of water industry infrastructure located in the area of operations of the Sydney Water Corporation and Hunter Water Corporation. However, this may be extended in the future.

5 Services that may be subject to declaration

5.1 Infrastructure services

The Act defines "infrastructure service" as:

> *"the storage, conveyance or reticulation of water or sewage by means of water industry infrastructure, and includes the provision of connections between any such infrastructure and the infrastructure of the person for whom water or sewage is stored, conveyed or reticulated, but:*
>
> *(a) does not include the storage of water behind a dam wall, and*
>
> *(b) does not include:*
>
> *(i) the filtering, treating or processing of water or sewage, or*
>
> *(ii) the use of a production process, or*
>
> *(iii) the use of intellectual property, or*
>
> *(iv) the supply of goods (including the supply of water or sewage),*
>
> *except to the extent to which it is a subsidiary but inseparable aspect of the storage, conveyance or reticulation of water or sewage."*

Delineation of the relevant service is a central issue in applying Part 3 and has been the subject of considerable argument in matters relating to other access regimes in Australia. A service cannot be declared if it is already the subject of an access undertaking accepted by IPART under section 38 of the Act.

The same infrastructure may provide different types of service and a number of instances or occasions of the same kind of service.

Example: ACT decision in *Re Services Sydney Pty Ltd* [2005] ACompT 7

In *Re Services Sydney Pty Ltd* [2005] ACompT 7 ("**Services Sydney decision**"), the ACT defined and declared the following services in the context of an application under Part IIIA of the TPA:

- A separate service for the transportation of sewage provided by means of each of the North Head, Bondi and Malabar Reticulation networks; and
- A separate service for the connection of new sewers to the North Head, Bondi and Malabar Reticulation Network at points of interconnection

5.2 Infrastructure services that are excluded

The Dictionary in the Act excludes the following from being the subject of declaration:

'the storage of water behind a dam wall'

The Act excludes declaration of the storage of water behind a dam wall.

'filtering, treating or processing of water or sewage'

The Act excludes declaration of the filtering, treating or processing of water or sewage except to the extent to which it is a subsidiary but inseparable aspect of the storage, conveyance or reticulation of water or sewage.

'the use of a production process'

The Act excludes declaration of the use of a production process except to the extent to which it is a subsidiary but inseparable aspect of the storage, conveyance or reticulation of water or sewage.

The "use of a production process" exemption was considered by the High Court in BHP Billiton Iron Ore Pty Ltd v National Competition Council [2008] HCA 45. A case study setting out the Court's consideration is provided as **Attachment E** to this Guide.

'the use of intellectual property'

The Act excludes declaration of the use of intellectual property except to the extent to which it is a subsidiary but inseparable aspect of the storage, conveyance or reticulation of water or sewage.

'the supply of goods (including the supply of water or sewage),'

The Act excludes from declaration the supply of goods (including the supply of water or sewage) except to the extent to which it is a subsidiary but inseparable aspect of the storage, conveyance or reticulation of water or sewage. For example, the use of gas to run compressors to provide transmission services on a pipeline could be considered to be an inseparable part of the services.

6 Criterion (a) - State significance

s. 23(a) The infrastructure is of State significance having regard to its nature and extent and its importance to the State economy.

6.1 Introduction

To fall within the scope of Part 3 of the Act, infrastructure must play a significant role in the State economy. While declaration is concerned with access to infrastructure services rather than access to the infrastructure itself, criterion (a) assesses the State significance of the infrastructure providing the service.

6.2 Tests of State significance

State significance of water industry infrastructure will be determined having regard to its:

(a) nature and extent; and

(b) importance to the State economy.

These elements, however, are not exhaustive. IPART may take into consideration any other material relevant to the State significance of a piece of infrastructure.

6.3 Nature and extent

Relevant indicators of the nature and extent of water industry infrastructure include physical capacity, the size and nature of the markets serviced by the infrastructure and the throughput of goods and services using the infrastructure. The physical dimensions of water industry infrastructure may also provide guidance on whether it is of State significance.

For example, the ACT considered the application of Part IIIA of the TPA in Sydney Services Decision at 181-185 the ACT considered whether to declare sewage services of three sewerage networks and took into account the population served by each network, the geographical scope of each network and combined throughput. The ACT also noted the pervasive use of sewage services by households, business and industry connected to the three networks. Furthermore, providing or failing to provide sewage services can impose significant environmental and health costs on the community and economy. Accordingly, the ACT was satisfied that, in the context of an application for access under Part IIIA of the TPA, each of the sewerage networks were of national significance.

6.4 Importance to the State economy

In its assessment of the importance of water industry infrastructure to the State economy, IPART focuses on the market(s) in which access would promote competition and the monetary value of trade that depends on the infrastructure.

IPART generally considers State significance to be established if any dependent market provides substantial annual sales revenue to participating businesses.

Example – NCC final recommendation in respect of The Lakes R Us application ("Lakes R Us Recommendation") for declaration of water storage and transport services November 2005.

The Lakes R Us application under Part IIIA of the TPA related to water storage and transport services provided by Snowy Hydro and State Water. The NCC considered the Snowy Hydro System to be of national significance within the meaning of section 44G(2)(c) of the TPA and noted, for example, the following factors:

- the scheme captures and diverts water within a catchment area of 5124 kilometres;
- the scheme consists of 7 power stations, 16 major dams, 80 kilometres of aqueducts, 145 kilometres of interconnected tunnels and a pumping station;
- the scheme supplies approximately 3 per cent of the electricity in the National Electricity Market ("**NEM**"), which services approximately 7.7 million energy customers in Queensland, New South Wales, the Australian Capital Territory, South Australia and Victoria; and
- farmlands irrigated by the Snowy Hydro scheme produce millions of dollars worth of crops every year for national and international markets.

7 Criterion (b) - not economically feasible to duplicate infrastructure

s. 23(b) that it would not be economically feasible to duplicate the infrastructure.

7.1 Introduction

Criterion (b) is essentially intended to limit declaration to services provided by infrastructure that exhibits natural monopoly characteristics. IPART must be satisfied that it is not economically feasible to duplicate the infrastructure that provides the service. This criterion is based on the inability of other businesses to compete on an equal basis or enter the market for the water infrastructure services because of the nature of the infrastructure.

7.2 IPART's methodology

In assessing whether criterion (b) is satisfied, IPART may have regard to:

(a) whether the infrastructure exhibits natural monopoly characteristics;

(b) the broad social construction of the term 'not economically feasible'.

7.3 Natural monopoly characteristics

Infrastructure may exhibit natural monopoly characteristics because of natural, economic or technological advantages associated with the initial establishment of the infrastructure. These advantages may be absolute in the sense that new businesses may be unable to access the same advantages as the incumbent.

Whether infrastructure exhibits natural monopoly characteristics is an economic question that involves complex analysis and will often be fact specific. Natural monopoly characteristics are common to significant infrastructure, where substantial fixed costs and low operating costs may combine to generate economies of scale and scope over the range of reasonably foreseeable demand. Generally, under these conditions, one piece of infrastructure can supply the entire range of demand more cheaply than two or more pieces of infrastructure can. This makes it economically efficient for only one piece of infrastructure to service the entire foreseeable range of demand; in other words, the development of another piece of infrastructure to provide the service would amount to a wasteful use of society's resources.

7.4 IPART's approach to natural monopoly

IPART considers that, as a guide, a natural monopoly exists if, for the relevant range of demand, it is always cheaper for a single piece of infrastructure rather than several to provide the service subject to declaration.

In assessing whether a piece of water industry infrastructure is a natural monopoly, IPART may consider factors such as:

- the size of the initial or start-up investment;

- the cost structure of operating the service;
- the existence of any other existing facilities that provide the defined service;
- the nature of demand for the service, particularly the dynamic aspects such as growth or otherwise in demand;
- the current and maximum potential capacity of the infrastructure;
- the particular technology employed to supply a service;
- the rate of technological innovation in the industry; and
- the existence of any environmental, planning or other regulations that prevent anyone else from building their own infrastructure.

In determining whether a natural monopoly exists, IPART also considers any incumbency advantages that confer a monopoly on a service provider. An incumbency advantage is a natural, economic or technological advantage associated with the initial establishment of infrastructure.

7.5 The ACT's approach in Sydney Services

In the Services Sydney decision, the ACT noted that the relevant infrastructure for consideration were Sydney Water's three major sewerage reticulation networks, which provide transport and interconnection services along and to the pipes serving the North Head, Bondi and Malabar sewage treatment works.

The ACT stressed that Sydney Water's sewage reticulation networks were the only infrastructure providing transport services between customer premises and potential interconnection points; and the only networks supplying or potentially supplying interconnection services.

The ACT stated:

> *"There is no dispute between the parties as to whether this criterion is satisfied. Pipelines, where capacity increases more than in proportion to circumference, are the classic example of economies of scale. Furthermore, water and wastewater infrastructure is characterised by particularly large and long lived fixed costs and particularly low variable costs. According to Sydney Water, the depreciated optimised replacement cost for each of the North Head, Bondi and Malabar reticulation networks was $2,243.6 million, $260.5 million and $2,878.8 million respectively in 2004. The sewerage reticulation network appears to have more than enough capacity to meet demand for at least the next fifteen years.*
>
> *The Tribunal is satisfied that it would be uneconomic to develop another facility to provide the services of transportation and interconnection which are the subject of the current application for declaration in the foreseeable future. We are also satisfied that it would be uneconomic to develop another facility that could provide part of the service (s 44H(4)).*"

A case study of the ACT's decision is set out at **Attachment C.**

7.6 IPART's approach to "not economically feasible"

IPART may adopt a broad social construction (rather than only taking a strictly commercial view) of the term 'not economically feasible' in criterion (b). While social considerations and private considerations are likely to lead to similar results in most cases, private considerations can sometimes make it commercially viable for an infrastructure owner to build another piece of infrastructure even though this would be inefficient if all social costs were considered.

In these circumstances, it is possible to envisage a case where criterion (b) is satisfied even though competing services exist. Criterion (b) is a test of whether water industry infrastructure can serve the range of foreseeable demand for the services provided by that infrastructure at less cost than that of two or more pieces of infrastructure. Therefore, if alternative infrastructure is developed but is inefficient from a broader social perspective, the mere fact that an alternative is available may not impact on a finding that criterion (b) is satisfied. However, the availability of alternative infrastructure may affect whether criterion (c) is satisfied.

8 Criterion (c) - promoting competition in another market

s. 23(c) that access (or an increase in access) to the service by third parties is necessary to promote a material increase in competition in an upstream or downstream market.

8.1 Introduction

Criterion (c) addresses whether infrastructure that exhibits natural monopoly characteristics, and thus satisfies criterion (b), is also bottleneck infrastructure. IPART must be satisfied that access would promote a material increase in competition in an upstream or downstream market.

The ACT noted in the Services Sydney decision in relation to Part IIIA of the TPA that the purpose of establishing an access regime is to open up 'bottlenecks' to competition and thereby unlock the potential benefits which competition may bring in dependent markets including, in particular, the benefits associated with economic efficiency.

8.2 IPART's methodology

In assessing whether criterion (c) is satisfied, IPART will:

(a) define the relevant market(s) in which competition may be promoted and verify that this market or these markets are separate from the market for the service to which access is sought; and

(b) determine whether access (or increased access) facilitated by declaration would promote a more competitive environment in the additional market(s), which requires assessing:

  (i) whether the incumbent has the ability and incentive to exercise market power to adversely affect competition in the dependent market(s); and

  (ii) whether the structure of the dependent market(s) is such that declaration would, by constraining the exercise of market power by the service provider to adversely affect competition in the dependent market(s), promote competition. In particular, high barriers to entry to the dependent markets that are unrelated to the existence of the bottleneck infrastructure may preclude any promotion of competition as a result of declaration.

8.3 Market definition

In considering the question of market definition, IPART may have regard to the work of the Australian Competition & Consumer Commission ("**ACCC**") (particularly guidance given in respect of mergers and acquisitions) in addition to adjudicators of access matters, such as the NCC and the Courts.

A market is the space in which rivalry and competition take place between firms. Substitution is key to market definition. Substitution involves switching from one product to another in response to a change in the relative price, service or quality of two products (holding unchanged all other

relevant factors, such as income, advertising or prices of third products). There are two types of substitution: demand-side substitution, which involves customer-switching; and supply-side substitution which involves supplier switching.

Relevantly, there are four dimensions to market definition:

(a) product dimension

The goods or services supplied must be identified in addition to the sources or potential sources of substitute products. Separate product markets exist if their respective products are not substitutable in demand or supply. In the context of the water industry, a "product" is in fact a water industry infrastructure service.

(b) geographic dimension

Each area that is supplied, or could be supplied in the practical sense, with the relevant product must be identified. National, intrastate or regional markets, for example, may be defined.

(c) functional dimension

IPART must be satisfied that declaration would promote competition in 'an upstream or downstream market'. In other words, a functionally distinct market from the market for the service must be identified. Markets will generally be functionally separate if the supply chain's layers of goods or services at issue are separable from an economic point of view (economically separable). Each layer must use assets sufficiently distinct and specific to that layer such that the assets cannot readily produce the output of the other layer (economically distinct).

(d) time dimension

The period over which substitution is possible must be considered. The temporal dimension may have an impact on how broadly the market is defined. With a longer time dimension, consumers have a greater ability to substitute other sources of supply in response to a price increase. To determine the temporal parameters of markets, IPART generally has regard to long run rather than short run substitution possibilities.

Examples of market definition for criterion (c)

In considering market delineation issues in the Services Sydney decision under Part IIIA of the TPA the ACT accepted dependent markets for:

- sewage collection;
- sewage treatment; and
- recycled water.

In considering market delineation issues in its final recommendation on the Lakes R Us Recommendation under Part IIIA of the TPA, the NCC considered competitive outcomes in the following markets:

- water trading markets;
- agricultural product markets in Australia; and
- peak time electricity generating markets.

8.4 Promotion of competition - access (or an increase in access) to the service

The fundamental question is whether the opportunities and environment for competition in market(s) upstream or downstream of the infrastructure would be enhanced if the services of the infrastructure were declared.

This question is assessed by a comparison of the future conditions and environment for competition with and without declaration.

Previous consideration of access applications by the ACT and the Courts give rise to a number of propositions in relation to this comparison.

(a) Existing access

The fact that the service provider is already providing access to the relevant services does not preclude declaration of those services on the basis that there is no material increase in competition. Declaration may provide existing or new users with additional access or access beyond that currently provided or on more efficient terms.

For example, the ACT declared services provided by the Sydney Airport Corporation Limited ("**SACL**") in the *Application of Virgin Blue Airlines Ltd* (2006) ATPR ¶42-092 ("**Virgin Blue decision**") despite SACL already providing access to those services. In that case, Virgin Blue sought declaration of an "airside service" under Part IIIA of the TPA. One of its principle issues were the changes by SACL to the way it levied aeronautical charges.

A case study of the Virgin Blue decision is set out at **Attachment F** to this Guide.

(b) Enhancing the competitive environment

In the Services Sydney decision, the ACT stated:

> *"the promotion of competition test does not require it to be satisfied that there would necessarily or immediately be a measurable increase in competition. Rather, consistent with the purpose of Pt IIIA being to unlock bottlenecks in the supply chain, declaration is concerned with improving the conditions for competition, by removing or reducing a significant barrier to entry. Other barriers to entry may remain and actual entry may still be difficult and take some time to occur, but as long as the Tribunal can be satisfied that declaration would remove a significant barrier to entry into at least one dependent market and that the probability of entry is thereby increased, competition will be promoted."*

The assessment of promotion of competition should focus on the impact of declaration on the competitive environment generally, rather than on particular competitors. Having said that, the ACT in Services Sydney went on to note that there must be some real prospect of entry into the dependent market within a reasonable time for competition to be promoted.

A case study of the Services Sydney decision is set out at **Attachment C** to this Guide.

(c) Workable and effective competition

IPART considers that the reference to "competition" in criterion (c) is a reference to workable and effective competition. Thus, where a dependent market is already effectively competitive, then any increase in competition beyond the level of effective competition is unlikely to deliver benefits sufficient to outweigh regulatory burdens.

8.5 Ability and incentive to exercise market power in dependent markets

In the *Duke Eastern Gas Pipeline Pty Ltd* (2001) ATPR 41-821 (**"Duke EGP decision**"), the ACT concluded that whether access will promote competition under the Gas Code critically depends on whether the access provider has *market power* that could be used to adversely affect competition in the dependent market(s). A case study of the Duke EGP decision is set out as **Attachment D** to this Guide.

As a first step, IPART works on the presumption that, as a result of satisfying criterion (b), the infrastructure's natural monopoly characteristics confer significant market power in the market for the service subject to declaration.

IPART then applies the ACT's approach in the Duke EGP decision by inquiring whether the service provider has the ability and the incentive to exercise its presumed market power to adversely affect competition in the dependent market(s).

In Australian trade practices law, 'market power' is thought of as the ability to profitably and sustainably raise prices above proper economic costs, or to behave in a market in some other manner for a sustained period, without being constrained by current or potential competitors. For example, such

market power could affect competition in dependent markets in the following ways:

- the service provider may charge monopoly prices for the provision of the services;
- the service provider may engage in explicit or implicit price collusion;
- a vertically integrated service provider may engage in strategic behaviour designed to leverage its presumed market power into the dependent market.

It is not necessary to establish that a service provider is actually engaging in this behaviour - it is sufficient if there is the incentive and ability to do so. However, any evidence of the service provider engaging in that kind of behaviour is likely to be a relevant consideration in determining whether the service provider has the incentive or ability to affect competition in dependent markets.

By contrast, the service provider may not have the ability and incentive to exercise market power to adversely affect competition in the dependent market(s) where:

- the infrastructure does not occupy a bottleneck position in the supply chain for the service;
- the service provider is constrained from exercising market power in the dependent market(s), perhaps by competitive conditions in the dependent market(s) or the market power of other participants in the market(s); or
- the incentives faced by the service provider are such that its optimal strategy is to exercise market power to pro-competitively affect competition in the dependent market(s). It may be profit maximising, for example, for a service provider to promote increased competition in the dependent market(s) and maximise demand for the services provided by the infrastructure.

For example, in the Duke EGP decision, the ACT found that Duke did not, and would not, have sufficient market power to hinder competition. This was due to the commercial imperatives Duke faced, the countervailing power of other market participants and the existence of spare pipeline capacity which incentivised Duke to maximise throughput on the EGP.

8.6 Market structure and barriers to entry

The ability and incentive for a service provider to exercise market power to adversely affect competition in a dependent market is a necessary (although not sufficient) condition for declaration.

A finding that the service provider has the ability and incentive to exercise market power to adversely affect competition in a dependent market is likely to mean that the barriers to entry in that market result from the natural monopoly characteristics of the infrastructure and its bottleneck position. In

the usual case, this finding would mean that declaration would reduce barriers to entry and promote competition in that dependent market.

However, IPART will consider the market structure of the dependent markets. In particular, it will consider the height of any barriers to entry in the dependent market that are unrelated to the natural monopoly and bottleneck characteristics of the facility.

High barriers to entry in the dependent market(s) may mean that declaration would not deliver a promotion of competition, despite the service provider having the ability and incentive to use market power to distort competition in the market(s). An example is the situation where a facility's natural monopoly and bottleneck characteristics confer market power on the service provider in the dependent market(s) yet prohibitive barriers to entry in the market(s) mean that the pro-competitive effects of declaration would be negligible.

The ACT considered such an argument by SACL in *Sydney International Airport: Re Review of Declaration of Freight Handling Facilities* (2000) ATPR¶41-754. The ACT explained the SACL argument as follows:

> *"In general terms it is fair to say that if barriers to entry are reduced competition will be promoted. The principal barrier to entry presently facing potential entrants to the ramp handling market at SIA is SACL's unchallengeable decision as to who should be allowed access to the relevant services, which decision is now administered through the tender process. If this barrier is removed then an opportunity is created for access.*
>
> *SACL submitted that there were such substantial barriers to entry to the ground handling services market that an access declaration would not promote competition as the barriers to entry would effectively inhibit new entrants. The barriers to entry were said to reside in the need to obtain a critical mass of business in order to survive, the constraints of space at the airport and the constraints of safety at the airport."*

The ACT appeared to accept that, in principle, substantial barriers to entry in the downstream market for ramp handling services would mean that declaration would not promote competition. It concluded, however, that the alleged constraints of space and safety at the airport did not raise a barrier to entry in the ramp handling services market and that the difficulty of building up a critical mass of business for long term viability, although real, did not erect such an insurmountable barrier to entry as to prevent declaration from promoting competition in that market.

Similarly, the ACT considered a similar argument in the Services Sydney decision. As set out in **Attachment C**, Sydney Water argued that there would not be a material increase in competition on the basis that Services Sydney's proposal was not viable and that it was effectively prohibited from entering the dependent markets because of existing regulations. Although the ACT accepted the proposal was extremely ambitious and entry would take a considerable time, declaration would still promote competition:

> *"The promotion of competition is a relative, rather than an absolute, concept. It is fundamental to this case that at present there is effectively no competition in any of the dependant markets because of the monopoly*

position of Sydney Water through control of the sewerage infrastructure. The facilitation of any competition in any such market is of significance."

Therefore, IPART considers that any barriers to entry unrelated to the natural monopoly and bottleneck characteristics of the facility will need to be significant. Otherwise, criterion (c) is likely to be satisfied where a service provider has the incentive and ability to affect competition in that market.

9 Criterion (d) - safe use of water industry infrastructure

s. 23(d) that the safe use of the infrastructure by access seekers can be ensured at an economically feasible cost and, if there is a safety requirement, that appropriate regulatory arrangements exist.

9.1 Introduction

The rationale for criterion (d) is that declaration should not occur where access or increased access to a service may pose a legitimate risk to human health or safety.

For a service to be declared, access must be possible without putting too much pressure on infrastructure systems or operations, and safe timetabling must be possible.

If the service provider is already allowing access to the infrastructure, this does not necessarily mean this access is safe within the meaning of criterion (d). IPART must still be satisfied that access can be provided in accordance with criterion (d) without undue risk to human health or safety.

For example, safety standards may be imposed by regulatory and licensing obligations, or could be set out in the terms and conditions of access which could address any issues. If these safety standards, however imposed, are at such a level that access seekers can use the infrastructure safely (i.e. without posing a legitimate risk to human health or safety) then criterion (d) will be satisfied.

9.2 IPART's methodology

In assessing whether criterion (d) is satisfied, IPART will determine whether:

(a) the safe use of the infrastructure by access seekers can be ensured at an economically feasible cost; and

(b) whether appropriate regulatory arrangements exist.

9.3 Regulatory and licensing obligations in New South Wales

Water industry infrastructure owners in New South Wales are subject to various licensing obligations that generally encompass safety requirements.

Part 2 of the Act introduces a licensing regime for network operators and retailers. Section 5 provides that:

> *"(1) A person must not:*
>
> *(A) construct, maintain or operate any water industry infrastructure, or*
>
> *(B) supply water, or provide a sewerage service, by means of any water industry infrastructure,*
>
> *otherwise than under the authority of a licence.*

Maximum penalty: 10,000 penalty units (in the case of a corporation) and 2,500 penalty units (in any other case).

(2) Subsection (1) (b) does not apply to or in respect of the supply of water, or the provision of sewerage services, by a licensed network operator to a licensed retail supplier.

(3) This section does not apply to a public water utility in relation to:

(a) the construction, maintenance or operation of water industry infrastructure situated within its area of operations, or

(b) the supply of water, or the provision of a sewerage service, by means of water industry infrastructure situated within its area of operations.

(4) This section does not apply to or in respect of:

(a) such water industry infrastructure as comprises water management works to which Chapter 4, 5 or 6 of the Water Management Act 2000 applies, or

(b) such other water industry infrastructure as is prescribed by the regulations.

Therefore, an application for declaration may also involve services that are subject to licensing obligations under Part 2. Relevantly, section 7 of the Act requires that the protection of public health, the environment, public safety and consumers is considered in determining whether or not to grant a licence.

Additionally, the water industry in New South Wales is subject to various health and safety laws. This was recognised by the ACT in the Services Sydney decision where it found that the service provider, Sydney Water, was subject to extensive health and safety regulation under the law. In the ACT's view, this meant that declaration would not cause health and safety risks as all access would be provided subject to this pre-existing regulation.

9.4 Terms and conditions of access

Criterion (d) may be satisfied where the terms and conditions on which access is provided could address any safety concerns raised by access to the service.

For example, in the Sydney Airports decision under Part IIIA of the TPA, the ACT concluded that any risk of serious accidents on airport aprons and surrounding areas could be addressed by including in the terms and conditions for ramp access:

- obligations on ramp users to satisfy strict safety requirements; and
- the right for Sydney Airport to apply sanctions on any ramp user who breaches those requirements.

Accordingly, safety requirements and their enforcement may be left to the negotiation stage after infrastructure is declared.

10 Criterion (e) - the public interest

s. 23(e) Access (or an increase in access) to the service would not be contrary to the public interest.

10.1 Introduction

Whether coverage declaration would not be contrary to the public interest involves a balancing exercise. If criteria (a) to (d) are met, then these may be public interest factors that favour declaration. These, and any other positive public interest factors that favour declaration, must be weighed against any detriments that may arise as a result of declaration. What may constitute a relevant public interest will vary from one application to another. IPART's approach is to focus on the effects of declaration on the welfare of the community as a whole.

The public interest criterion is not an additional positive requirement: it cannot challenge the conclusion that criteria (a)-(d) are satisfied. Instead, it queries whether there are any other matters not yet considered which may indicate that declaration is contrary to the public interest. For example, IPART must be satisfied that the overall costs of declaring services provided by bottleneck or essential infrastructure do not outweigh the overall benefits of such declaration.

When assessing the extent of the benefits of declaration, regard may be had to the likely effect of declaration on competition in related markets considered under criterion (c) and the resultant positive effects on economic efficiency identified under criterion (e).

10.2 IPART's methodology

In assessing whether criterion (e) is satisfied, factors IPART may have regard to include:

(a) economic efficiency;

(b) future investment;

(c) regulation; and

(d) other public interest considerations.

10.3 Economic efficiency

A key public interest consideration is the net impact of declaration on economic efficiency. Economic efficiency must be assessed from the perspective of society as a whole: what is the best use of society's resources to maximise welfare?

The ACT set out the relevant types of economic efficiency to public benefit consideration in a merger authorisation context in *Re Qantas Airways Limited* [2004] ACompT 9. These are:

- allocative efficiency, which relates to optimising the allocation of resources to improve the market's outcome;

- dynamic efficiency, which relates to how firms adapt to innovation, change and the evolving supply and demand forces of the market; and

- productive efficiency, which relates to the most efficient use of resources or technology available to a firm at any point in time.

It is important to avoid declaration where it may yield short term static gains in productive and allocative efficiency that constrain the realisation of longer term dynamic efficiency gains. The following table shows the potential efficiency gains and losses in respect of declaration.

Table - potential gains and losses of economic efficiency in the context of declaration

	Potential efficiency gains if a service is declared	Potential efficiency costs if a service is declared
Allocative efficiency	If the terms and conditions of access are appropriate, then all customers who value the service more than its cost of supply will be serviced.	In the short term, the distortion of price signals, which may result in the allocation of resources to the provision of services that are not of most value to society.
Dynamic efficiency	In the longer term, competitive pressures may stimulate innovative approaches to reducing costs and developing new products.	In the longer term, the dampening of incentives for innovation.
Productive efficiency	In the short term, the entry, or threat of entry, of new firms in downstream markets may encourage lower production costs for services such as the supply of electricity to households.	In the longer term, the deterrence of investment.

10.4 Future investment

The impact of declaration on future investment in the water industry is an important consideration. The New South Wales Minister for Water Utilities, has stated that one of the purposes of the Act is to harness the innovation and investment potential of the private sector in the water and wastewater industries. Declaration must therefore not work against this purpose.

10.5 Regulation

IPART recognises the inherent regulatory burdens that may result from declaration. These burdens may lead to economic efficiency losses that are relevant to an assessment of the public interest criterion. Direct regulatory costs that may follow declaration include:

- the costs of negotiating access with third parties; or

- arbitrating an access dispute.

Indirect regulatory costs that may follow declaration include:

- reduced incentives to invest in essential infrastructure;
- reduced incentives to innovate or provide flexible services; or
- inflexible terms in access contracts, especially pricing clauses, which may make it difficult for market participants to respond to changing market conditions.

In the context of criterion (e), the regulatory burden must be clearly proven. In *Virgin Blue Airlines Pty Ltd* [2005] AcompT 5, in relation to an application for access under Part IIIA of the TPA, SACL argued that the regulating airport facilities would bring about significant costs, such as arbitration and the distortion of efficient investment and production decisions, which would outweigh any benefits. The ACT, however, rejected this argument as it was sceptical of evidence put before it. In particular, the ACT did not look favourably on arguments relating to the burden of arbitration in circumstances where it was merely speculative that arbitration may be necessary and, in any event, the legislation anticipated a quick and cost-efficient arbitration process.

10.6 Other public interest considerations

While no attempt to list public interest considerations can be exhaustive, matters that IPART may consider include the following items in clause 1(3) of the Competition Principles Agreement:

- ecologically sustainable development;
- social welfare and equity considerations, including community service obligations;
- government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity;
- economic and regional development, including employment and investment growth;
- the interests of consumers generally or of a class of consumers;
- the competitiveness of Australian businesses; and
- the efficient allocation of resources.

Other relevant matters may include impending access regimes or arrangements, national developments, the desirability for consistency across access regimes, relevant historical matters and privacy.

To the extent relevant, IPART may also have regard to some of the factors set out in section 15(1) of the IPART Act as follows:

- the effect on general price inflation over the medium term;
- the social impact of the determinations and recommendations; and

- standards of quality, reliability and safety of the services concerned (whether those standards are specified by legislation, agreement or otherwise).

Examples of public interest assessment

In the Lakes R Us Recommendation under Part IIIA of the TPA, the NCC affirmed that it adopts a broad view as to the types of matters that may raise public interest considerations.

The NCC determined that declaration would not be in the public interest because it would require changes that affect the existing water extraction rights of other parties and the proposal had the potential to impose significant costs on a range of parties, including state governments, water users and the environment.

11 Duration

11.1 Coverage and binding non-coverage declaration

Sections 27 (in relation to coverage declaration) and 36 (in relation to binding non-coverage declaration) of the Act requires that declaration must state the period for which it is to have effect. Unless the declaration is renewed under sections 26 or 37 (respectively as above) of the Act or revoked under sections 30 or 37 (respectively as above) of the Act, it will have effect until the end of the stated period.

Furthermore, a declaration will not have effect in relation to a service while that service is the subject of an access undertaking developed under section 38 of the Act.

The period of declaration will vary according the circumstances of each application. In considering the appropriate duration of a declaration, IPART may have regard to factors including:

- the importance of long term certainty for businesses;
- allowing time for any access disputes to be negotiated or determined by arbitration;
- the likelihood that the infrastructure will be duplicated in the future to provide a competing service;
- the need for declaration to apply for a sufficient period to be able to influence the pattern of competition in any relevant dependent market; and
- the desirability of periodic review of access regulation governing services, including the need for declaration itself. On the expiry of a declaration, the need for ongoing regulation can be reviewed.

11.2 Revocation if criteria no longer met

The Minister may revoke declaration of a service. As part of this process, section 29 of the Act requires that IPART must furnish a report, in respect of revocation of coverage declaration, to the Minister about whether declaration of the service should be revoked or not. If IPART recommends revocation, it must be satisfied that the declaration criteria would no longer be satisfied in relation to the declared service(s) for which revocation is sought.

IPART notes that declaration does not constrain parties from negotiating access rights that continue beyond the period of the declaration.

12 Glossary of terms and abbreviations

ACCC	Australian Competition & Consumer Commission
ACT	Australian Competition Tribunal
Act	*Water Industry Competition Act 2006 (NSW)*
BHPBIO	BHP Billiton Iron Ore
Downstream market	Market at the next stage of the production/distribution chain
Duke EGP decision	*Duke Eastern Gas Pipeline Pty Ltd* (2001) ATPR 41–821
EGP	Eastern Gas Pipeline
Fortescue	Fortescue Metals Group Ltd
Fortescue decision	*Re Fortescue Metals Group Limited* [2006] ACompT 6
Gas Code	*National Third Party Access Code for Natural Gas Pipeline Systems* (now replaced by the National Gas Acts)
Hamersley Iron decision	*Hamersley Iron Pty Ltd v. National Competition Council and others* (1999) ATPR ¶41–705
Infrastructure service	The Act defines infrastructure service as follows: *"infrastructure service means the storage, conveyance or reticulation of water or sewage by means of water industry infrastructure, and includes the provision of connections between any such infrastructure and the infrastructure of the person for whom water or sewage is stored, conveyed or reticulated, but:* *(a) does not include the storage of water behind a dam wall, and* *(b) does not include:* *(i) the filtering, treating or processing of water or sewage, or* *(ii) the use of a production process, or* *(iii) the use of intellectual property, or* *(iv) the supply of goods (including the supply of water or sewage),* *except to the extent to which it is a subsidiary but inseparable aspect of the storage, conveyance or reticulation of water or sewage."*
IPART	Independent Pricing and Regulatory Tribunal
Lakes R Us Recommendation	The National Competition Council's final recommendation on *The Lakes R Us Application for Declaration of Water Storage and Transport Services* (8 September 2005)
MSP	Moomba-Sydney Pipeline
National Gas Acts	Legislation enacted by the states and territories in Australia to codify and replace the Gas Code
NCC	National Competition Council
NCC Guide	National Competition Council Guide to Part IIIA of the TPA (2002)

Services Sydney decision	*Re Services Sydney Pty Ltd* [2005] ACompT 7
Sewerage infrastructure	The Act defines sewerage infrastructure in the following way: *"sewerage infrastructure means any infrastructure that is, or is to be, used for the treatment, storage, conveyance or reticulation of sewage, including any outfall pipe or other work that stores or conveys water leaving the infrastructure, but does not include any pipe, fitting or apparatus that is situated upstream of a customer's connection point to a sewer main."*
TPA	*Trade Practices Act 1974 (Cth)*
Upstream market	Market at the previous stage of the production/distribution chain
Virgin Blue decision	*Application of Virgin Blue Airlines Ltd* (2006) ATPR ¶42-092
Water infrastructure	The Act defines water infrastructure in the following way: *"water infrastructure means any infrastructure that is, or is to be, used for the production, treatment, filtration, storage, conveyance or reticulation of water, but does not include:* *(a) any pipe, fitting or apparatus that is situated downstream of a customer's connection point to a water main, or* *(b) any pipe, fitting or apparatus that is situated upstream of a customer's connection point to a stormwater drain."*
Water industry infrastructure	The Act defines water industry infrastructure as water infrastructure or sewerage infrastructure.

Attachment A: Application timeline

	Pre-application discussions with IPART
Calendar day 0	Duly completed application lodged
Calendar day 3	IPART furnishes the application to and invites submissions from: – the service provider (except where the service provider has made the application); and – the Minister/s administering the *Protection of the Environment Operations Act 1997*, the *Public Health Act 1991*, the Water *Industry Competition Act 2006* and the *Water Management Act 2000* Public notification of application: – IPART posts the application on its website; – IPART places a public notice in the newspaper inviting submissions from the public; and – In the case of applications for revocation, IPART must provide a copy of the application to the access seeker
Calendar day 30	Closing of submissions in response to Application
Calendar day 80	Draft report released and submissions invited on draft report
Calendar day 100	Closing of submissions in response to draft report
By Calendar day 120	Final report provided to the Minister
By Calendar day 180	The Minister makes a decision on the application

The above timetable is indicative only. Specific milestones may also be affected by public holidays and weekends.

Attachment B: Criteria comparison

A comparison of the declaration criteria of Australian access regulation legislation

Legislation	Section 23 of the Act	Sections 44G(2) and 44H(4) of the TPA	Section 15 of the National Gas Acts
Significance	"(a) that the infrastructure is of State significance, having regard to its nature and extent and its importance to the State economy,"	"(c) that the facility is of national significance, having regard to: (i) the size of the facility; or (ii) the importance of the facility to constitutional trade or commerce; or (iii) the importance of the facility to the national economy;"	Not applicable
Developing a New Facility	"(b) that it would not be economically feasible to duplicate the infrastructure,"	"(b) that it would be uneconomical for anyone to develop another facility to provide the service;"	"b) that it would be uneconomic for anyone to develop another pipeline to provide the pipeline services provided by means of the Pipeline;"
Promoting Competition	"(c) that access (or an increase in access) to the service by third parties is necessary to promote a material increase in competition in an upstream or downstream market,"	"(a) that access (or increased access) to the service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service;"	"a) that access (or increased access) to pipeline services provided by means of the pipeline would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the pipeline services provided by means of the pipeline;"
Safety	"(d) that the safe use of the infrastructure by access seekers can be ensured at an economically feasible cost and, if there is a safety requirement, that appropriate regulatory arrangements exist,"	"(d) that access to the service can be provided without undue risk to human health or safety;"	"c) that access (or increased access) to the pipeline services provided by means of the pipeline can be provided without undue risk to human health or safety;"
Public Interest	"(e) that access (or an increase in access) to the service would not be contrary to the public interest."	"(f) that access (or increased access) to the service would not be contrary to the public interest."	"d) that access (or increased access) to the pipeline services provided by means of the pipeline would not be contrary to the public interest."
Pre-existing Access Regime		"(e) that access to the service is not already the subject of an effective access regime;"	

Attachment C: Case Study One

Re Application by Services Sydney Pty Ltd [2005] ACOMPT 7

1.1 Background

In September 2005, Services Sydney Pty Limited ("**Services Sydney**") applied to the ACT for a review of the NSW Premier's decision not to declare sewage services under the TPA. These services were defined as sewage interconnection and transportation services provided by Sydney Water, a statutory state-owned corporation, as part of the North Head, Bondi and Malabar Reticulation networks ("**Sydney Water sewerage network**"). Services Sydney was seeking declaration as part of its proposal to offer alternative sewage treatment services in the greater Sydney area.

1.2 Decision of the ACT

The ACT concluded that the Sydney Water sewerage network services should be declared, having regard to the promotion of competition in dependent markets, the high costs of duplicating the network and the national significance of the network.

1.3 TPA criterion (c): national significance

The ACT found the Sydney Water sewerage network to be nationally significant for several reasons:

- it accounted for over 30% of all reticulation networks in Australia;
- households, businesses and industry in the greater Sydney area used it pervasively;
- withdrawal of its services would have a major environmental and health impact on the community and economy.

1.4 TPA criterion (b): uneconomic to develop another facility

The Sydney Water sewerage network was the only set of facilities providing the sewage interconnection and transportation services sought to be declared. Without access to the Sydney Water sewerage network, a new entrant would need to duplicate the network at a high cost. The network was also found to have sufficient capacity to meet demand for the services for at least the next 15 years. Accordingly, this criterion was satisfied.

1.5 TPA criterion (a): access would promote competition in a dependent market

The ACT isolated three downstream markets in which sewage services had the potential to promote competition:

- the sewage collection market;

- the sewage treatment market; and
- the recycled water market.

The ACT concentrated on two arguments raised by Sydney Water as to why access would not materially promote competition in the above markets.

First, Sydney Water argued that Services Sydney's proposal was not technically or commercially feasible. The ACT rejected this argument. While Sydney Services' plan was extremely ambitious, the ACT was not satisfied that it was not viable.

Second, Sydney Water contended that entry to the sewage market by a competing service provider was effectively barred by legislation, with the licences to operate infrastructure and the need for power to enter or acquire lands constituting serious barriers. After reviewing the terms of Sydney Water's licence and the freedom of purchasers to choose other providers, the ACT concluded that Sydney Water had no statutory monopoly over sewage collection services. However, it was clear that new entry would take a considerable period of time.

The ACT also made the following points:

- it does not need to be satisfied that there would necessarily or immediately be a measurable increase in competition;
- other barriers to entry may remain and new entry be difficult so long as it can be satisfied that declaration would remove a significant barrier to entry and the probability of entry is thereby increased;
- promotion of competition is a relative concept - here there is effectively no competition in the dependent markets such that facilitation of any competition is significant; and
- once a service is declared, any other potential entrant may gain access and the ACT must consider whether competition is promoted not whether a particular competitor's interest will be promoted, although there must be some real prospect of entry within a reasonable time for competition to be promoted.

The ACT then considered the individual markets and concluded that competition would be promoted in the sewage collection market and the recycled water market. In both cases, access to the services provided by Sydney Water would be required for effective competition in those markets.

1.6 TPA criterion (f): public interest

A number of public interest grounds were raised against declaration. The main argument was that IPART had recommended the introduction of a state based access regime covering the relevant services. This recommendation had been accepted by the Government but not yet implemented. This regime would provide a unified system of regulation, including prices, access and service standards. In effect, it was argued that it would not be in the public interest to make a declaration with the impending introduction of this regime. The ACT rejected this argument. There was no guarantee such a regime would be introduced and, if it were, Sydney Water could seek a

revocation of the declaration. The ACT also noted that negotiations with Sydney Water commenced in 1998 and there had been ample time to introduce this regime in the intervening 6 years.

1.7 Conclusion

The decision not to declare the transportation and interconnection services of the Sydney Water sewerage network was set aside. The ACT was not convinced that the highly regulated nature of the sewage services market rendered declaration ineffective by barring any new entrant from access.

Attachment D: Case Study Two

Duke Eastern Gas Pipeline Pty Ltd (2001) ATPR 41–821

1.1 Background

In October 2000, the Commonwealth Minister for Industry, Science and Resources decided that the Eastern Gas Pipeline ("**EGP**"), which transmitted gas from Southern Victoria to the Sydney region, should be a covered pipeline under the Gas Code. The Minister made his decision following an application by AGL Energy to the National Competition Council for a recommendation that the EGP be a covered pipeline. In 2001, the owner of the EGP, Duke Eastern Gas Pipeline Pty Ltd ("**Duke**"), appealed the decision to the ACT, and it was set aside.

1.2 Focus of the ACT

The focus of the ACT's determination was whether coverage of the EGP would promote competition in at least one market, contained in criterion (a) of the Gas Code and criterion (b), as to whether it would be uneconomic to develop any other competing pipeline to provide the relevant services.

1.3 Gas Code Criterion (b): uneconomic to develop another pipeline

The ACT stated that if the EGP could meet market demand at less cost than two or more pipelines, it would be uneconomic to develop another pipeline to provide the same services, because those services are most efficiently provided by the existing pipeline.

The ACT characterised the haulage services for which declaration was sought as the haulage of gas from one point to another point on the EGP as opposed to providing services to markets at the receipt and delivery points of the pipeline. As a result of this "point to point" approach, the ACT considered that the Moomba-Sydney Pipeline ("**MSP**") was incapable of being developed to provide competing services for those of the EGP, as the MSP ran from South Australia to Sydney, while the EGP ran from Southern Victoria to Sydney.

In contrast, the Interconnect was considered to be capable of being developed to provide competing services as, like the EGP, it sourced gas from Victoria. The ACT found that although there was high foreseeable demand for gas transmission services along the Victoria-NSW route, it would be uneconomic to develop the Interconnect to the extent required to cater for this demand.

1.4 Gas Code Criterion (a): access would promote competition in a dependent market

The ACT found two dependent markets in which the EGP gas haulage services had the potential to promote competition:

- downstream - the sale of gas to users in South East Australia; and
- upstream - the production of gas.

The ACT concluded that declaration of the EGP would not promote competition in any of these markets over the existing voluntary, non-discriminatory access policies offered by Duke to third parties seeking access to the infrastructure. The most important factor in the ACT's reasoning was that the EGP did not, and would not, have sufficient market power to hinder competition. Reasons for this conclusion were the commercial imperatives Duke faced, the countervailing power of other market participants and the existence of spare pipeline capacity.

In particular, Duke has a strong commercial incentive to increase throughput of the EGP given its high capital cost, low operating costs and spare capacity.

The ACT also found that in conjunction with the EGP, the two other major competitors, the MSP and the Interconnect, possessed enough spare capacity to cover forecasted demand for the next ten to fifteen years. This meant that the EGP priced above competitive levels and spare capacity on the other pipelines could be used to defeat a price rise.

The ACT pointed out that:

- long term contracts did not necessarily undermine purchasers' ability to respond to price hikes, as these contracts commonly included price review clauses and there was evidence that recontracting and new contracting would occur;

- for regional markets where the EGP was the sole gas supply, the ACT was not satisfied coverage would promote competition because these were new markets and the EGP was competing with other fuel sources and the threat of regulation existed.

The ACT found that coverage of the EGP would not, therefore, create an environment which would improve competition from what competition would be without coverage.

1.5 Conclusion

Duke's lack of market power meant that the ACT was not satisfied competition would be promoted over the existing voluntary, non-discriminatory policies provided by Duke to third parties seeking pipeline access. Therefore, the ACT ordered the decision for the EGP to be covered to be set aside.

Attachment E: Case Study Three

BHP Billiton Iron Ore Pty Ltd v National Competition Council [2008] HCA 45

1.1 Background

BHP Billiton Iron Ore ("**BHPBIO**") transports iron ore produced at its Pilbara mines to Port Hedland by rail. In 2004, Fortescue Metals Group Ltd ("**Fortescue**") applied to have certain services declared under Part IIIA of the TPA so it could use parts of the BHPBIO rail network to transport its iron ore to Port Hedland.

BHPBIO resisted Fortescue's application on various grounds, including its assertion that the rail services are part of an exempt "production process". Part IIIA excludes "use of a production process" from services capable of being declared, and BHPBIO considered rail transportation of iron ore from mine to port to be a fully integrated part of its iron ore production cycle.

Four courts have examined the production process exemption in relation to Pilbara rail services, taking a number of different approaches. The High Court has now clarified that services to which access is sought will not fall within the exemption simply because they form part of a production process if the access seeker is not seeking use of the production process itself.

1.2 The Hamersley approach

The application of the production process exemption in this context was first considered by the Federal Court in *Hamersley Iron Pty Ltd v the National Competition Council and others* (1999) ATPR ¶41–705. This decision involved an application to have rail services declared under the TPA. Kenny J found that Hamersley's rail services were an exempt "production process" because the rail services were a necessary component of a highly integrated production process used by Hamersley to produce export grade iron ore. The exemption was found to apply to the use of a whole production process and also any integral part of it.

1.3 The Middleton approach

At first instance in the Fortescue decision, Middleton J rejected Kenny J's reasoning. The only relevant question according to Middleton J was whether the infrastructure to which access was sought was, of itself, used to make or create something. Middleton J found that the "production process" exemption did not apply to BHPBIO's rail operations because the infrastructure - the rail line - is not, of itself, used to "make or create anything".

1.4 Full Federal Court decision

The majority found the key elements of the "production process" exemption to be:

- identification of the service sought by the access seeker;

- identification of the scope and content of the production process; and
- whether that service involves the use of that production process.

The majority disagreed with Middleton J that a production process must be "transformative", that is changing the state of the product, for the exemption to apply. It also found that the exemption did not cover the use of part of a production process, a point over which the minority judge disagreed. Consequently, BHPBIO's appeal was dismissed.

However, the majority stated that the exemption would apply if the use of a step in a highly integrated production process is so invasive and disruptive that the third party is in substance and effect using that production process.

1.5 High Court decision

The High Court unanimously upheld that the exemption did not apply to use of the Pilbara rail services:

- while the rail services are an integral step in the iron ore production process of BHPBIO, Fortescue was seeking use of the track, not use of the rolling stock operated by BHPBIO;
- consistent with the majority decision in the Federal Court, Fortescue was only seeking to use infrastructure (the rail line) that BHPBIO uses for the purposes of its production process - it was not seeking use of the production process itself; and
- while BHPBIO's construction that use of part of a production process enlivened the exemption was not untenable, the alternative construction was the only one which would advance the objectives of Part IIIA.

The High Court did not discuss the issue of use of an invasive or disruptive part of a production process. However, it pointed out that any issues relating to access to the Pilbara rail services by Fortescue would be determined over the course of the declaration process, taking into account a number of factors including the legitimate business interests of BHPBIO.

Attachment F: Case Study Four

Application of Virgin Blue Airlines Ltd (2006) ATPR 42-092

1.1 Background

In 2003, after extensive discussions with the ACCC and other parties, Sydney Airport Corporation Limited ("**SACL**") changed the way it levied aeronautical charges. Virgin Blue objected to these changes. In October 2002, prior to the change occurring, Virgin sought to have an "airside service" declared under Part IIIA of the TPA. Virgin argued that the changes to the levy demonstrated that SACL had the ability and incentive to exercise market power to adversely affect competition in dependent markets.

1.2 NCC determination

Virgin Blue applied to the NCC in October 2002 for a recommendation that airside services at Sydney Airport be declared. Airside services include landing, takeoff and movement between runways and passenger arrival and departure gates.

In *NCC Application by Virgin Blue for Declaration of the Airside Service at Sydney Airport: Final Recommendation* (November 2003) the NCC considered the application of the competition criterion. The NCC concluded that criteria (a), relating to promotion of competition, and (f), relating to the public interest, were not met. Relevantly, the NCC found that SACL had the requisite ability to exercise its natural monopoly power, but not the incentive because SACL was subject to the threat of re-regulation by the government in the event that it was to exercise market power.

Therefore, the NCC recommended that the services should not be declared. The Parliamentary Secretary to the Treasurer accepted its recommendation in January 2004. Virgin Blue applied to the ACT for a review of that decision.

1.3 ACT decision

On 9 December 2005, the ACT handed down a determination in favour of Virgin Blue, against a decision of the Parliamentary Secretary to the Treasurer not to declare domestic airside services at Sydney Airport.

Notwithstanding Virgin already had the use of the facility of Sydney Airport, the ACT found that increased access to airside services by way of declaration would promote competition in the market for the carriage of domestic air passengers into and out of Sydney.

The ACT also briefly considered the public interest and found that increased access would not be contrary to the public interest. The ACT concluded that additional costs need not necessarily arise, as negotiations only result in arbitration if the parties do not reach agreement. It considered that this form of regulation was consistent with the government's policy of light-handed regulation. The costs of regulation were given little weight by the ACT, due to arbitration only being the "default" option available to the parties if negotiations fail.

1.4 ACT decision - the competition test

The ACT's determination focused on the question of whether increased access to the airside services would promote competition in a dependent market. The dependent market identified was the market for the carriage of domestic air passengers into and out of Sydney.

In assessing the counterfactual, the ACT determined that its task was to:

> *"establish that, in the counterfactual, SACL's use of monopoly power in relation to use of the Airside Service would have an adverse impact on competition in the dependent market which would not exist in the factual with declaration. We are guided by SACL's past conduct in assessing how it will act in the future. Where SACL has misused its monopoly power in the past in such a way that has adversely impacted on competition in the dependent market, we can assume that in the future without declaration SACL will continue to misuse its monopoly power in a way which will have an adverse impact on competition in the dependent market. In the factual, SACL will be constrained from misusing its monopoly power in the future because commercial negotiations will be conducted with the knowledge that, in default of agreement, independent arbitration is available."*

The ACT also made the following findings:

- Declaration would enhance competition in the dependent market by creating opportunities for competitive behaviour. It found that the pre-existing lack of declaration had enabled SACL to exercise its monopoly power, principally through alterations to its pricing policy. These alterations involved a move from a charge based on an aircraft's maximum take-off weight to a charge per passenger carried.

- The alterations were found to favour Qantas and as such were a use of monopoly power. However, the ACT acknowledged that per passenger based charging has been adopted by a number of other Australian airports and accepted it as a legitimate basis for charging for international airside services at Sydney Airport.

- SACL had the ability and the incentive to exercise its monopoly power to determine both price and non-price terms in its negotiations with airlines and that negotiations would result in outcomes which would be unlikely to arise in a competitive environment. The ACT did not accept that SACL was constrained by the countervailing power of the airlines or the threat of the re-introduction of price controls. It also dismissed SACL's incentive to increase competition in the downstream market to maximise its non-aeronautical revenues.

- The future without declaration would be likely to result in SACL's charges continuing on a per passenger basis, protracted contract negotiations, a lack of minimum service standards, new and increased charges for services and a transfer of risk to the airlines. The ACT considered that declaration would permit the ACCC to arbitrate these matters, enhancing the environment for competition.

The ACT concluded that competition in the market for the carriage of domestic air passengers into and out of Sydney would be promoted because SACL would be less likely to raise its prices in such a way as to reduce the

benefits to airlines of using Sydney Airport or favour full-service over low-cost carriers.

Unlike the NCC, the ACT found that forming a judgment as to SACL's future conduct was not contingent on whether or not SACL had an incentive to exercise monopoly power in a manner which adversely affects competition in the dependent market. The ACT held that the focus should be on ability to exercise market power, and whether that ability had been translated into conduct in the past and was likely to be translated into conduct in the future.

1.5 The Full Federal Court discussion of the competition test

SACL appealed the ACT's decision to the Full Federal Court on the basis of an error of law and in particular the ACT's approach to the with and without test.

The Full Federal Court considered that the behaviour of the infrastructure owner may be relevant in deciding whether or not to declare a service only to the extent that it informs the decision-making process.

The Full Federal Court said the word "access" should be given its ordinary meaning; it should not be taken to mean regulated access under Pt IIIA. The decision-maker must compare the future state of competition in the dependant market with access, and without it (or with only limited access), rather than comparing access as currently provided with access under a declaration. This is because declaration means any third party can negotiate access, including those who may not currently have access.

SACL applied to the High Court for special leave to appeal the Full Federal Court's decision. However, the High Court declined this application.