AUSTRALIAN COMPETITION TRIBUNAL

Application by Services Sydney Pty Limited [2005] ACompT 7

TRADE PRACTICES – Part IIIA of the *Trade Practices Act 1974* (Cth) – application pursuant to s 44K(2) – application for a review of a deemed decision not to declare certain services by the designated Minister, the Premier of New South Wales, under s 44H(9) – services described as 'interconnection services' and 'transportation services' provided by Sydney Water Corporation – jurisdiction of Tribunal to make a declaration – whether criteria in s 44H(4) satisfied – where a State Government has announced an intention to develop an effective access regime consistent with s 44G(3) – the meaning of 'access' for the purposes of s 44H(4)(a) and (f) – the meaning of 'market' for the purposes of s 44H(4)(a) – whether access to the service would promote competition in at least one market, other than in the market for interconnection and transportation services, or in the dependent markets being sewage collection services, sewage treatment services and recycled water, for the purposes of s 44H(4)(a) – whether access to Sydney Water's sewerage reticulation system would not be contrary to the public interest for the purposes of s 44H(4)(f)

WORDS AND PHRASES – '*access*', '*market*', *'promote competition'*

Independent Pricing and Regulatory Tribunal Act 1992 (NSW), s 18(2)
Independent Pricing and Regulatory Tribunal and other Legislation Amendment Act 2000 (NSW)
Sydney Water Act 1994 (NSW), ss 10(2), 10(3), 12, 14, 21, 22, 35, 39, 49, 55, 56, 57, 91, 210 Pt 5, Pt 6 Div 7, Pt 7 Div 8
Trade Practices Act 1974 (Cth), ss 4E, 44B, 44F, 44F(1), 44H, 44H(2), 44H(4), 44H(4)(a)-(f), 44H(9), 44J, 44K, 44K(2), 44K(4), 44K(5), 44K(8), 44L, 44N, 44V(3), 44X, 44ZZA, 46, Pt IIIA, Pt IV

Australian Competition and Consumer Commission v Rural Press Ltd, (2003) 216 CLR 53; (2003) ATPR 41-965 cited
Re Australian Union of Students (1997) 147 ALR 458; (1997) ATPR 41-573 cited
Cambridge Credit Corporation Ltd v Parkes Developments Pty Ltd [1974] 2 NSWLR 590 cited
Cooper Brookes (Wollongong) Pty Ltd v Federal Commissioner of Taxation (1981) 147 CLR 297 cited
Minister for Immigration and Multicultural Affairs v Bhardwaj (2002) 209 CLR 597 considered
Project Blue Sky Inc v Australian Broadcasting Authority (1998) 194 CLR 355 cited
Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Co. Ltd (1989) 167 CLR 177 cited
Rail Access Corporation v NSW Minerals Council Ltd (1998) 87 FCR 517; (1998) ATPR 41-663 cited

Re Duke Eastern Gas Pipeline Pty Ltd (2001) ATPR 41-821 considered
Re Queensland Co-operative Milling Association Ltd (1976) 8 ALR 481; (1976) ATPR 40-012 applied
Re Review of Freight Handling Services at Sydney International Airport (2000) ATPR 41-754 considered
Re Virgin Blue Airlines Pty Limited [2005] ACompT 5 considered
Rural Press Ltd v Australian Competition and Consumer Commission (2002) 118 FCR 236; (2002) ATPR 41-883 cited
Scurr v Brisbane City Council (No 5) (1973) 133 CLR 242 cited
Universal Music Australia Pty Ltd v ACCC (2003) 131 FCR 529; (2003) ATPR 41-947 cited

M Brunt, *Market Definition Issues in Australian and New Zealand Trade Practices Litigation*, (1990) 18 ABLR 86

APPLICATION FOR REVIEW OF THE DEEMED DECISION BY THE PREMIER OF NEW SOUTH WALES DATED 2 FEBRUARY 2005 UNDER SECTION 44H(9) OF THE TRADE PRACTICES ACT 1974 (CTH) IN RELATION TO THE APPLICATION FOR DECLARATION OF SEWAGE INTERCONNECTION AND TRANSPORTATION SERVICES PROVIDED BY SYDNEY WATER CORPORATION
BY SERVICES SYDNEY PTY LIMITED (ACN 084 481 103)

NO 1 OF 2005

GYLES J (DEPUTY PRESIDENT), MR B KEANE, DR J WALKER
21 DECEMBER 2005
SYDNEY

GENERAL DISTRIBUTION

IN THE AUSTRALIAN COMPETITION TRIBUNAL **NO 1 OF 2005**

RE:	**APPLICATION FOR REVIEW OF THE DEEMED DECISION BY THE PREMIER OF NEW SOUTH WALES DATED 2 FEBRUARY 2005 UNDER SECTION 44H(9) OF THE TRADE PRACTICES ACT 1974 (CTH) IN RELATION TO THE APPLICATION FOR DECLARATION OF SEWAGE INTERCONNECTION AND TRANSPORTATION SERVICES PROVIDED BY SYDNEY WATER CORPORATION**
BY:	**SERVICES SYDNEY PTY LIMITED (ACN 084 481 103) APPLICANT**
THE TRIBUNAL:	**GYLES J (DEPUTY PRESIDENT), MR B KEANE, DR J WALKER**
DATE:	**21 DECEMBER 2005**
PLACE:	**SYDNEY**

THE TRIBUNAL makes the following determination pursuant to s 44K(8)(b) of the *Trade Practices Act 1974* (Cth):

1. The deemed decision of the Premier of New South Wales dated 2 February 2005 not to declare sewage interconnection and transportation services provided by Sydney Water Corporation on the application by Services Sydney Pty Limited is set aside.

2. The Tribunal declares:

   (a) A service for the transportation of sewage provided by means of the North Head Reticulation Network, from a customer's boundary trap to points of interconnection.

   (b) A service for the connection of new sewers to the North Head Reticulation Network at points of interconnection.

   (c) A service for the transportation of sewage provided by means of the Bondi Reticulation Network, from a customer's boundary trap to points of interconnection.

(d) A service for connection of new sewers to the Bondi Reticulation Network at points of interconnection.

(e) A service for the transportation of sewage provided by means of the Malabar Reticulation Network, from a customer's boundary trap to points of interconnection.

(f) A service for connection of new sewers to the Malabar Reticulation Network at points of interconnection.

3. That the declarations in the above paragraph 2 shall be effective on and from 21 December 2005 and shall expire on 20 December 2055.

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REASONS FOR DECISION

INTRODUCTION

1 On 18 February 2005, Services Sydney Pty Limited (ACN 084 481 103) (Services Sydney) applied to the Australian Competition Tribunal (the Tribunal) under s 44K(2) of the *Trade Practices Act 1974* (Cth) (the Act) for a review of the deemed decision by the designated Minister, the Hon Robert Carr, Premier of New South Wales (NSW) (the Minister) under s 44H(9) of the Act, not to declare certain services. The services were described in Services Sydney's application to the Tribunal as follows:

> *'(a) a service for the connection of new sewers to Sydney Water Corporation's ("Sydney Water") sewage reticulation network(s) at points of interconnection ("Interconnection Service"); and*
>
> *(b) a service for the transportation of sewage provided by means of Sydney Water's sewage reticulation network(s), from a customer's boundary trap to points of interconnection ("Transportation Service").'*

2 Declaration under Pt IIIA of the Act is one process through which third parties can gain access to what are often described as 'essential facilities' or natural monopolies, to

which access is required in order to compete in a related market. These particular terms do not, however, appear in the Act. Rather, Pt IIIA of the Act provides for the declaration of a 'service provided by means of a facility' (s 44B of the Act) where the application meets certain criteria. Hence, a service is distinguished from a facility, although the service may simply involve the use of a facility (*Rail Access Corporation v NSW Minerals Council Ltd* (1998) 87 FCR 517 at p524, (1998) ATPR 41-663 at 41,389). Declaration is only possible where access is not already available through either an access undertaking that has been accepted by the Australian Competition and Consumer Commission (ACCC) under s 44ZZA of the Act, or through a state or territory access regime that has been found to be 'effective' under s 44N. Once a service is declared, an access seeker has the right to negotiate terms and conditions of access with the service provider, and to have those terms and conditions arbitrated by the ACCC when a dispute is notified.

3 In the first instance, it is for the National Competition Council (NCC) to recommend (s 44F of the Act), and the designated Minister to determine (s 44H of the Act), whether a service should be declared. If the Minister fails to publish a declaration, or the reasons for not declaring the service, within 60 days of receiving a recommendation from the NCC, the Minister is taken to have decided not to declare the service (s 44H(9) of the Act). The Minister's decision is reviewable by the Tribunal (s 44K of the Act).

4 Services Sydney originally applied to the NCC on the 3 March 2004 for a recommendation to declare the following services:

> *'(1) a service for the transmission of sewage via Sydney Water's Sydney Sewage Reticulation Network from the Customer Collection Points to the Interconnection Points (Transmission Service); and*
>
> *(2) a service for connection of new trunk main sewers owned and operated by Services Sydney to the existing Sydney Sewage Reticulation Network at the Interconnection Points (Interconnection Service).'*

5 This specification of the services was narrow, designed to facilitate access by Services Sydney to transportation and interconnection services relating to particular interconnection points between the sewerage reticulation network operated by Sydney Water Corporation (Sydney Water) and Services Sydney's trunk main sewers. Declaration under the Act, however, is not concerned with providing access for any particular individual or business. Once a service is declared, any party can seek access and have the terms and conditions of

access arbitrated by the ACCC. The NCC considered that the services specified in the application were too narrowly focused on Services Sydney's particular business plan and should be described in more general terms.

6 The NCC further concluded that there are three relevant facilities, namely the Northern Suburbs Ocean Outfall Sewer (NSOOS), the Bondi Ocean Outfall Sewer (BOOS) and the South Western Suburbs Ocean Outfall Sewer (SWSOOS). Since the NCC agreed that transportation and interconnection were separate services, which should be defined in relation to each of the three facilities, they recommended that a total of six services be declared.

7 Accordingly, on 1 December 2004, the NCC recommended declaration of more broadly defined services for transportation to 'points of interconnection' on each of the three sewerage reticulation networks and for the 'connection of new sewers' to those sewerage reticulation networks as follows:

> *'(a) A service for the transportation of sewage provided by means of the North Head Reticulation Network, from a customer's boundary trap to points of interconnection.*
>
> *(b) A service for the connection of new sewers to the North Head Reticulation Network at points of interconnection.*
>
> *(c) A service for the transportation of sewage provided by means of the Bondi Reticulation Network, from a customer's boundary trap to points of interconnection.*
>
> *(d) A service for connection of new sewers to the Bondi Reticulation Network at points of interconnection.*
>
> *(e) A service for the transportation of sewage provided by means of the Malabar Reticulation Network, from a customer's boundary trap to points of interconnection.*
>
> *(f) A service for connection of new sewers to the Malabar Reticulation Network at points of interconnection.'*

8 The Minister did not publish a declaration, or his reasons for not declaring the services, within 60 days of receiving the recommendation from the NCC, and was thus taken to have decided not to declare the services. Accordingly, Services Sydney made the current application to the Tribunal.

9 The Tribunal's review is a re-consideration of the matter (s 44K(4) of the Act). In other words, it is not an appeal and the Tribunal can consider new information and evidence that was not available to the NCC or the Minister. For the purposes of the review, the Tribunal has the same powers as the designated Minister (s 44K(5) of the Act) and may affirm or set aside the Minister's decision (s 44K(8) of the Act).

10 Before the Tribunal can declare the services, it must be satisfied that all the criteria in s 44H(4) of the Act are satisfied:

> *'(a) that access (or increased access) to the service would promote competition in at least one market (whether or not in Australia), other than the market for the service;*
>
> *(b) that it would be uneconomical for anyone to develop another facility to provide the service;*
>
> *(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;*
>
> *(d) that access to the service can be provided without undue risk to human health or safety;*
>
> *(e) that access to the service is not already the subject of an effective access regime;*
>
> *(f) that access (or increased access) to the service would not be contrary to the public interest.'*

The Tribunal must also consider whether it would be economical for anyone to develop another facility that could provide part of the service (s 44H(2) of the Act).

THE FACILITIES AND THE SERVICES

11 As noted earlier, the Act provides for the declaration of services provided by means of facilities, rather than for the declaration of the facilities themselves. As previously mentioned, it is the NCC's view that in this case there are three relevant facilities, being each of the NSOOS, BOOS and SWSOOS sewerage reticulation systems, and six relevant transportation and interconnection services, as opposed to the one facility and two services for which Services Sydney originally requested declaration. The NCC is also of the view that the services should be defined broadly as transportation and interconnection services, rather than services relating to specific points of interconnection with Services Sydney's sewers.

12 Services Sydney's application to the Tribunal adopted the NCC's more generic definition of the services and defined the facility or facilities in the alternative as either a single Sydney reticulation network, a combination of the three major reticulation networks, or each major reticulation network separately. Sydney Water argued that there were three separate facilities.

13 The Act does not define a 'facility' for the purposes of Pt IIIA of the Act. In *Re Review of Freight Handling Services at Sydney International Airport* (2000) ATPR 41-754 (*Re Sydney International Airport*), the Tribunal said (at 40,771) that:

> *'…a facility for the purposes of the Act is a physical asset (or set of assets) essential for service provision and which also exhibits the features of a natural monopoly.'*

and (at 40,791) that:

> *'A key issue is the minimum bundle of assets required to provide the relevant services subject to declaration.'*

14 Debate between the parties focused on the extent to which the three networks were interconnected, either physically or operationally. Both parties agreed that the networks were not currently physically interconnected. Services Sydney argued that while physically separate, the three networks are fully integrated and coordinated in terms of staffing, operation and maintenance, they provide common services and the licences for the three networks are virtually identical. Sydney Water argued that each of the reticulation networks is separate and distinct, licensed and operated separately and with quite different characteristics.

15 Applying the Tribunal's 'minimum bundle of assets' test to the current matter, the Tribunal agrees with the NCC's view that there are three relevant facilities. It is quite conceivable that a new entrant could offer sewage collection services only to customers connected to one of the three reticulation networks, accessing transportation and interconnection services along that network, from which the sewage would be conveyed to a sewage treatment plant for processing and disposal. It would not be essential to access transportation and interconnection services provided by *each* of the reticulation networks in order to compete.

16 A ‘service provided by means of a facility’ is defined, non-exhaustively, by the Act (s 44B) to include the use of an infrastructure facility and the handling or transporting of things. The Act specifically excludes the supply of goods or the use of intellectual property or a production process as relevant services for Pt IIIA. Clearly the services for which declaration is sought fit within the types of services to which Pt IIIA was designed to apply.

17 Sydney Water argued that the services for which Services Sydney are seeking declaration lack sufficient specificity, that the transportation service should be defined as a point to point service and the interconnection service should be defined in terms of specific points of interconnection. The Tribunal does not accept this argument. If a service is declared, access will potentially be available to anyone seeking it, not just Services Sydney. The Tribunal agrees with the NCC that the definition of the services for the purpose of declaration needs to be sufficiently broad to be relevant to alternative entry plans. The specific location of interconnection points is something that can be determined as part of the negotiation and arbitration of the terms and conditions of access.

18 The Tribunal is of the opinion that there are three relevant facilities, being each of the NSOOS, BOOS and SWSOOS. As interconnection services may be required independently of transportation services (for example, by sewer miners), the Tribunal is of opinion that there are six relevant services, and adopts the NCC’s definition of those services.

JURISDICTION

19 Sydney Water submits that the Tribunal has no jurisdiction to make the declaration sought or, indeed, any declaration. It is submitted that there is disconformity between the services identified by Services Sydney in its application to the NCC and those identified in the recommendation for declaration by the NCC to the Minister. It is also submitted by Sydney Water that there is disconformity between the declaration now sought by Services Sydney and that recommended by the NCC. Reliance is placed upon the decision of the High Court in *Minister for Immigration and Multicultural Affairs v Bhardwaj* (2002) 209 CLR 597 (*Bhardwaj*).

20 The Tribunal does not determine its own jurisdiction. However, it is appropriate to give some consideration to the issue as, if the submission were clearly correct, it would not be

right to continue. In our opinion, the submission is not clearly correct and, indeed, is incorrect, for the reasons that follow.

21 It is clear enough that the NCC is limited to dealing with the application made to it pursuant to s 44F(1) of the Act. It is also clear enough that a recommendation to declare must be limited to the particular service identified in the application. However, that does not require a literal or pedantic adherence to the nature of the application or to the particular description of the service when deciding whether the same application and the same service is being dealt with. There is well-established authority to that effect in relation to planning approvals (see the discussion by Hope JA in *Cambridge Credit Corporation Ltd v Parkes Developments Pty Ltd* [1974] 2 NSWLR 590, particularly at 599, and the many later cases that have cited it).

22 Statutory provisions should be construed in context, bearing in mind the consequences of a literal construction, in order to give provisions the meaning that the legislature is taken to have intended them to have (*Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355 per McHugh, Gummow, Kirby and Hayne JJ at 384). Purposive construction is required by s 15AA of the *Acts Interpretation Act 1901* (Cth). Incongruous or capricious results are to be avoided (*Cooper Brookes (Wollongong) Pty Ltd v Federal Commissioner of Taxation* (1981) 147 CLR 297).

23 In the present case the splitting of the facility (and so the services) into three does not affect the substance of the service to be declared in any respect material to this case. It is the kind of precise and detailed formality that does not affect substantial compliance with the statutory regime (cf Stephen J in *Scurr v Brisbane City Council (No 5)* (1973) 133 CLR 242 at 256). The added flexibility in relation to interconnection provided by the NCC recommendation does not change the essential nature of the application or the service. A literal and pedantic construction of the provision would not accord with the wider purpose of Pt IIIA of the Act and would create anomalous and capricious results – as this case would illustrate if Sydney Water's submission were to be accepted.

24 The reference to *Bhardwaj* does not assist the debate. That case deals with the consequences of a decision that is made in breach of an essential statutory condition.

THE SEWAGE INDUSTRY

25 'Sewage' is a combination of water-carried waste removed from residences, institutions and commercial and industrial establishments, together with such groundwater, surface water and stormwater as may be present, that is discharged into a sewerage reticulation network. 'Wastewater' is a somewhat broader term, which includes discarded water of any origin, clean or contaminated, that is discharged into a sewerage or stormwater drainage system.

The collection and processing of sewage

26 In Sydney today, sewage is generally, but not always, transported from customer premises via a sewerage reticulation network to a sewage treatment plant, where it is processed prior to being discharged into the environment (rivers and oceans) as 'effluent'. 'Sewerage' refers to the pipes and associated infrastructure through which the sewage is transported and 'sewerage reticulation network' refers to the network of pipes and fittings that collect sewage from customer properties and transport it to a sewage treatment plant or discharge point. The transportation of sewage through sewerage reticulation networks is primarily by gravity, following natural catchment drainage lines, supplemented by pumping stations.

27 Sewage may be processed in different ways and to various levels. The level of treatment generally ranges from high rate primary (the lowest) to tertiary (the highest). Some or all of the sewage may also be recycled as 'biosolids', used in agriculture, and recycled water, currently used for non-drinking purposes by households, agriculture and industry.

28 Primary treatment involves the removal of solid particles from the sewage through screening, skimming and sedimentation. High rate primary treatment involves higher loading rates and hence removes fewer materials. Secondary treatment removes dissolved and suspended organic and inorganic solids through bacterial decomposition. Tertiary treatment involves the removal of further inorganic compounds, and substances such as the plant nutrients nitrogen and phosphorous, and fine particles. Tertiary processing may involve physical, biological and/or chemical processes. Disinfection can be applied at any treatment level to inactivate disease-causing micro-organisms such as bacteria, viruses and parasites.

29 Disinfected secondary treated sewage can be used as recycled water for uses involving minimal human contact, such as pasture irrigation and coal washing and conveyance. Disinfected tertiary treated sewage produces a high quality recycled water that is suitable for all types of non-potable use. A further treatment stage, generally involving reverse osmosis, can be used to treat tertiary treated reclaimed water to a higher standard, known as potable water, suitable for blending with fresh water supplies that are further treated to produce drinking water.

Public health and environmental externalities

30 An important characteristic of sewage collection, treatment and disposal (or lack thereof) is that it involves significant externalities associated with public health and environmental impacts. Externalities occur where, absent regulation, costs or benefits from certain activities are not transacted through markets. Consequently, suppliers and consumers may not take those costs and benefits into account when making production and consumption decisions, resulting in a misallocation of resources. Failure to collect sewage can have adverse health and environmental consequences, not just for the particular customer to whom services are not supplied. The level of treatment and the amount of recycling of sewage determines the environmental impact of sewage disposal. The damming of rivers and consequent reduction of flows can have adverse consequences for river health, but it is possible to use higher level treated and recycled water for 'environmental flows' which improve river health.

31 One of the health and environmental problems associated with sewerage systems is that of overflow, where untreated sewage is discharged into the environment. Sydney Water's sewerage reticulation network has sufficient capacity to avoid dry weather overflows. Nevertheless, such overflows may occur, for example, when there are blockages in the system or when a pump fails. Wet weather overflows occur because of water ingress into the sewerage pipes through cracks and faults during periods of rain. While wet weather flows only represent a 10 per cent increase on dry weather flows when spread across the year, they can produce flows which are several times as large as dry weather flows at any particular time. Sydney Water's three major reticulation networks have sufficient capacity to carry wet weather flows three to five times their dry weather flow capacity. When wet weather flows exceed these capacities, wet weather overflows occur. These overflows occur at specifically

designed overflow points, preventing sewage from backing up into customer premises. There are 3,000 designated overflow points in Sydney Water's reticulation networks.

32 Another major health and environmental problem with sewerage systems is the harmful or dangerous substances associated with trade waste. These substances could contaminate the rivers and oceans into which sewage is discharged and the biosolids and recycled water which could otherwise be reclaimed from the sewage. They may also cause corrosion and the potential collapse of sewerage pipes and create health problems for anyone exposed to them. Sydney Water's trade waste policy aims to control the volume and composition of substances that can be discharged into sewers, through treatment and removal of substances before trade waste enters the sewer.

33 Sydney Water's trade waste customers are divided into three categories, 'deemed business processes', 'commercial' and 'industrial', which produce sewage containing increasing levels of contaminants and which are accordingly subject to increasingly stringent controls. Deemed business processes discharge small quantities of waste and are permitted to do so without negotiating a permit, subject to meeting certain standard pre-treatment and other requirements. Commercial customers require a permit before being allowed to discharge trade waste into the sewer. They are generally required to install and maintain pre-treatment equipment, such as grease traps, but are not generally required to conduct sampling of their trade waste. Industrial customers require individual consent agreements before they can discharge trade waste into the sewer. These agreements are based on specific site and process information, sampling of waste and risk assessment. Where trade waste water is not acceptable for discharge into the sewer, producers must make their own arrangements for treatment and disposal. Charges for trade waste reflect the cost of treating sewage and include both management fees and volumetric charges, which reflect both the quantity and content of the waste.

34 Where pricing mechanisms fail to contain the levels of certain trade waste substances in the network to acceptable levels, Sydney Water will engage in direct negotiations with customers to reduce discharges and may apply 'load capping'. Where individual trade waste customers fail to comply with the requirements of their permit or consent, they are required to implement an effluent improvement program. Where customers break a condition of their permit or consent, they will be issued with a default notice and if they fail to comply with

this, they may be disconnected or prosecuted by Sydney Water. It is a criminal offence to discharge trade waste into Sydney Water's sewers except with the approval of Sydney Water (s 49 of the *Sydney Water Act*).

35 The existence of externalities in the supply of sewage (and water) services is one reason why they have traditionally been supplied by vertically integrated public utilities in Australia.

History and current industry structure

36 Until relatively recently, the function of sewage disposal was seen as a duty rather than a privilege. It was traditionally a function of local government. This is still the case for much of New South Wales. It was the case in the city of Sydney from 1850 (*Act 14 Victoria No 41*). In 1888 the function was effectively transferred to the Board of Water Supply and Sewage (*Metropolitan Water and Sewerage Act of 1880*; *Metropolitan Water and Sewerage Amendment Act of 1888*). That body was succeeded by the Metropolitan Water Sewerage and Drainage Board in 1924 (*Metropolitan Water Sewerage and Drainage Act 1924* (NSW)) and was reconstituted in 1987 as the Water Board (the *Water Board Act 1987* (NSW)). Local government and other statutory authorities operate sewerage systems elsewhere in New South Wales (eg *Local Government Act 1993* (NSW), Pt 3 Div 2).

37 The ownership and control of the developing infrastructure for the supply of sewerage services made academic any competition in relation to sewage collection, treatment and disposal. The public authorities in the respective geographical areas performed all of those services. By 1994 the landscape had begun to change. The then NSW Government was ahead of its time in commercialising public services. The *State Owned Corporations Act 1989* (NSW) (SOC) introduced corporatisation. The *Water Board (Corporatisation) Act 1994* (NSW), now known as the *Sydney Water Act 1994* (NSW), applied that concept to the Water Board.

38 The Water Board became a Company State Owned Corporation known as Sydney Water Corporation Limited. That Act introduced the concept of an Operating Licence to provide (inter alia) sewerage services (Pt 5 of the *Sydney Water Act*). The initial term of the licence was to be for a maximum of five years. If the Operating Licence is cancelled, the Governor may vest the assets, rights and liabilities of the Corporation in the Crown or another

person (s 210 of the *Sydney Water Act*). The Sydney Water Corporation Licence Regulator was established to undertake an operational audit of compliance by the Sydney Water Corporation with the Operating Licence. That Act also introduced the concept of customer contracts (Pt 6 Div 7 of the *Sydney Water Act*).

39 Following problems with the quality of Sydney drinking water, substantial amendments were passed in 1998 transferring catchment management functions to the Sydney Catchment Authority (*Sydney Water Catchment Management Act 1998* (NSW)). The *Water Legislation Amendment (Drinking Water and Corporate Structure) Act 1998* (NSW) changed the status of the Sydney Water Corporation Limited from a Company State Owned Corporation to a Statutory State Owned Corporation known as Sydney Water Corporation. The *Independent Pricing and Regulatory Tribunal and other Legislation Amendment Act 2000* (NSW) transferred the functions of regulating Sydney Water Corporation's Operating Licence compliance and pricing determinations to the Independent Pricing and Regulatory Tribunal of NSW (IPART). The Operating Licence and customer contract provisions continued.

40 The collection, treatment and disposal of sewage is one half of the 'water cycle'. The other half is the supply of drinking water through a second reticulation system to households and businesses. Sydney Water is currently a vertically integrated monopoly supplier of both water and sewage services in Sydney, the Blue Mountains and the Illawarra. It collects and disposes of more than 1.2 billion litres of sewage from around 1.6 million residential, non-residential and trade waste customers. It has 28 sewerage reticulation networks and 31 sewage treatment plants.

41 Other vertical and horizontal structures are possible, however, and are observed both historically and currently in other parts of Australia and the rest of the world. The supply of water and sewage services in Melbourne was restructured during the 1990s to separate out the supply of bulk water and the processing of sewage by Melbourne Water from the local reticulation of water supply and sewage collection by a number of local monopolies, who are subject to 'yardstick competition' by the regulator. In England and Wales, the supply of drinking water is being opened up to third party competition, through a process of licensing and access to the incumbent reticulation systems.

42 Sydney Water does not, however, conduct all its activities in house. Section 91 of the *Sydney Water Act* relevantly provides:

> ***'91 Contracting out***
> *(1) The Corporation may enter into a contract or other arrangement with any person for the provision, construction, operation, management or maintenance of systems or services that are the subject of an operating licence or for the carrying out of any of its other activities.'*

Sydney Water currently contracts out some elements of the supply chain, such as meter reading, maintenance and vehicle fleet management. It also uses various 'build own operate' or 'design, build and operate' arrangements with the private sector to obtain some water filtration and sewage treatment services, including the Veolia Water sewerage reticulation and treatment project at Gerringong/Gerroa. Sydney Water estimates that private sector competitive tenders currently account for 35 per cent of its total operating expenditure and 90 per cent of its capital expenditure.

43 The three major sewerage reticulation networks in Sydney are the NSOOS, which is connected to the North Head sewage treatment plant; the BOOS, which is connected to the Bondi sewage treatment plant; and the SWSOOS, which is connected to the Malabar sewage treatment plant. Sewage is treated to high rate primary levels at these sewage treatment plants. The sewer line is owned by the property owner up to and including the junction with Sydney Water's sewer.

44 Sydney Water also supplies recycled water to a number of domestic and commercial customers. For example, the Rouse Hill Recycled Water Area Project involves the reticulated supply of recycled water for non-drinking purposes to more than 15,000 households in the area via a 'third pipe' reticulation system. Similar systems are being considered for other areas. Sydney Water is currently commissioning a plant to supply recycled water to Blue Scope Steel, which will use nearly 70 to 80 per cent of sewage coming into the Wollongong sewage treatment plant. Recycled water is also being used as 'process water' for cooling purposes in the operation of the North Head sewage treatment plant, and there are plans to develop a similar scheme for Malabar. Recycled water is also supplied for agricultural use and for watering various golf courses in Sydney.

45 'Sewer mining' is a term used to describe the extraction of sewage from trunk sewers and its treatment by physical, chemical and/or biological processes to produce reclaimed

water suitable for specific end uses. Sewer mining generally involves the connection of a pipe owned by the sewer miner to the trunk sewer to extract and transport the sewage to the sewer miner's treatment plant. After processing, sludge, grit and screenings may be returned to the trunk sewer by another pipe, while the recycled water is transported to end users by a pipe or network of pipes. Sydney Water has established a process for dealing with enquiries from potential sewer miners. However, only the Sydney Olympic Park Authority (SOPA) is currently engaged in the mining of Sydney Water's sewers. SOPA extracts sewage from the Sydney Olympic Park area and pumps it through its own pipes to its treatment and water reclamation facilities. The reclaimed water is then supplied to the venues and facilities of Sydney Olympic Park and the residents of Newington via a 'third pipe' system owned by SOPA. SOPA charges residents of Newington for the recycled water, the price of which is set at 15c/KL less than the price of drinking water supplied by Sydney Water. Sydney Water continues to supply drinking water and sewage collection services and collects the recycled water fees on behalf of SOPA. SOPA has no contractual relationship with the occupiers of premises from which sewage is collected in relation to that service and receives no revenue from that source.

Regulation

46 The two distinguishing characteristics of the sewage collection, processing and disposal industry discussed above, namely health and environmental externalities and monopoly supply, underpin the extensive regulatory regime within which Sydney Water operates.

47 The principal functions of Sydney Water are to provide, construct, operate, manage or maintain systems or services for storing or supplying water, providing sewerage services, providing stormwater services or disposing of waste water (s 12 of the *Sydney Water Act*), to the extent that it is so enabled by its Operating Licence.

48 Section 21 of the *Sydney Water Act* provides that the principal objectives of Sydney Water are to be a successful business, operating at least as efficiently as any comparable business, maximising the net worth of the State's investment in it and exhibiting a sense of social responsibility; to protect the environment; and to protect public health by supplying safe drinking water. Section 22 of the *Sydney Water Act* further provides that Sydney Water

also has certain special objectives of reducing risk to human health and preventing degradation of the environment.

49 Sydney Water is required, by cl 11.3.1 of its Operating Licence, to comply with competitive neutrality policies and guidelines adopted by NSW and is also subject to Pt IV of the Act:

> *'**11.3 Competitive neutrality***
>
> *11.3.1 Subject to the Act, the SOC Act and any applicable law, Sydney Water must comply, and must ensure that its Subsidiaries comply, with the competitive neutrality policies and guidelines adopted by New South Wales under clause 3 of the Competition Principles Agreement.*
>
> *11.3.2 This Part is in addition to any obligations of Sydney Water under the Trade Practices Act 1974 and the Competition Code of NSW and other States and Territories as applicable.'*

Section 46 of the Act is noted as an example.

50 The Operating Licence is one of the principal means by which Sydney Water's operations are regulated. The terms and conditions of the Operating Licence are determined by the Governor, but must include those matters set out in s 14 of the *Sydney Water Act*, which includes a requirement to supply commercially viable sewerage systems and services in its area of operations, the specification of service standards and the compilation of environmental impact indicators. The current Operating Licence was issued on 1 July 2005 for a period of five years and includes explicit permission for Sydney Water to supply recycled water as well as those services listed in s 12 of the *Sydney Water Act* (cl 14).

51 Clauses 10.1–10.4 of the Operating Licence are as follows:

> *'**10.1 What the Licence authorises and regulates***
>
> *10.1.1 This Licence is granted to enable and require Sydney Water to provide, construct, operate, manage and maintain efficient, co-ordinated and commercially viable systems for providing the Services throughout the Area of Operations.*
>
> *10.1.2 Sydney Water must ensure that its systems and Services comply with the quality and performance standards required in this Licence or required to be developed under this Licence.*
>
> ***10.2 Powers not limited***
>
> *This Licence does not restrict or affect Sydney Water's power to*

carry out any functions imposed under any applicable law.

10.3 Area of Operations

The Area of Operations may be varied only as permitted under the Act.

10.4 Connection of Services

10.4.1 Subject to Sydney Water continuing to be in compliance with any applicable law, Sydney Water must ensure that its Services are available for connection on request to any Property situated in the Area of Operations.

10.4.2 Connection to the Services is subject to any conditions Sydney Water may lawfully determine to ensure the safe, reliable and financially viable supply of Services to Properties in the Area of Operations in accordance with this Licence. Satisfactory compliance with the conditions of connection is an essential requirement for gaining Sydney Water's approval for connection of the land to a water main or sewer main under section 56(2) of the Act.'

Sydney Water's 'services' are defined by cl 14.1 of the Operating Licence as the following services of Sydney Water permitted by the Operating Licence and any applicable law:

(a) storing and supplying water;

(b) providing sewerage services;

(c) providing stormwater drainage services;

(d) disposing of waste water; and

(e) recycled water.

52 Sydney Water is obliged to connect any property within its area of operations to its sewerage reticulation network on request. Sydney Water's area of operations can only be varied by the Governor (s 10(2) of the *Sydney Water Act*) if the Minister is satisfied that similar services will be provided by another public entity specified in s 10(3) of the *Sydney Water Act*.

53 Clause 10.5 of the Operating Licence provides that:

'This licence does not prohibit another person from providing services in the Area of Operations that are the same as or similar to the Services, if the person is lawfully entitled to do so.'

54 Division 7 of Pt 6 of the *Sydney Water Act* deals with customer contracts and is of some importance. The provisions include:

> *'**54 Publication of terms and conditions of customer contracts***
>
> *(1) The terms and conditions of customer contracts are to be set out in the operating licence or licences that relate to the provision of water supply or sewerage services by the Corporation.*
>
> *(2) (Repealed)*
>
> *(3) The terms and conditions must include particulars of the contract charges or of the manner in which the contract charges are to be calculated or determined in relation to the provision of water supply or sewerage services to customers by the Corporation.*
>
> *(4), (5)(Repealed)*
>
> ***55 Owner of land taken to have entered into customer contract***
>
> *(1) An owner of land that is connected to a water main or sewer main owned by the Corporation is taken to have entered into a customer contract with the Corporation, on the terms and conditions set out in the relevant operating licence or licences as varied from time to time in accordance with section 59, for the provision of water supply or sewerage services, or either of them, to the land.*
>
> *(2) In addition, a customer contract may also include terms and conditions relating to the imposition and payment of charges imposed under section 64 or 65. If a customer contract makes provision for such matters, a person by whom one or more of the charges are payable is taken to have entered into a customer contract with the Corporation on those terms and conditions.*
>
> *(3) A customer contract is not unjust, unconscionable, harsh or oppressive for the purposes of any law.*
>
> *(4) This section has effect subject to section 56.*
>
> *…*
>
> ***57 Division not to apply to certain contracts***
>
> *(1) This Division does not apply to the extent that the terms and conditions of a contract or other arrangement for the provision of water supply or sewerage or stormwater drainage systems, or any of them, have been specifically agreed to by the Corporation and a person who is taken to have entered into a customer contract under section 55.*
>
> *…*
>
> ***59 Variation of customer contracts***
>
> *(1) The terms and conditions of a customer contract may, subject to the approval of the Governor, be varied by the Corporation by a notice setting out or summarising the variation and published in a daily newspaper circulating in the area of operations. The notice must be*

published at least 6 months before the variation becomes effective or within a shorter period approved by the Minister.

…

(4) Subsections (1)–(3) do not apply to the variation of the terms and conditions of a customer contract to the extent that the variation relates to alteration of the level of fees or charges and the alteration is in accordance with a determination of the Independent Pricing and Regulatory Tribunal.'

55 Accordingly, once connected to Sydney Water's sewerage reticulation network, a deemed contract comes into existence between the customer and Sydney Water, on terms and conditions set out in the Operating Licence. Variation of the terms and conditions, other than fees and charges, is subject to the Governor's approval. The deemed customer contract is dealt with in cl 5 of the Operating Licence as follows (so far as presently relevant):

*'**5.1. Customer Contract***

5.1.1 The Customer Contract applies for the purpose of section 54 of the Act and may only be varied in accordance with section 59 of the Act.

5.1.2 Subject to section 56 of the Act, the Customer Contract automatically applies to persons specified in section 55(1) of the Act.

5.1.3 The Customer Contract sets out the rights and obligations of Customers and Sydney Water in relation to the Services provided through systems required under this Licence. These rights and obligations are in addition to the rights and obligations conferred by the Act and any other law.

…

5.1.10 As provided by and subject to section 57 of the Act, Sydney Water may enter into other contracts or arrangements for the supply of Services. The terms of any such contract or arrangement are such as may be negotiated between Sydney Water and any such person.'

56 The standard form customer contract is set out in Schedule 6 to the Operating Licence and includes the following clauses:

'2.2 Who is covered by this contract?

You are our customer and you are covered by this contract if you are the owner of property within our area of operations that is connected to a water main or sewer main owned by us, except where that connection has not been authorised or approved by us.

You are also our customer and covered by this contract (except parts 3, 6, 10 and clauses 8.1, 8.2 and 8.3) if:

- *you are the owner of property that is within a declared stormwater drainage area; or*

- *you are liable to pay us an availability charge and we have not exempted you from that charge or waived payment of that charge.*

2.3 Other agreements with us

If you have a separate agreement with us (for example a trade waste agreement), this contract will apply so far as it is not inconsistent with that agreement.

We may enter a separate agreement with you for the provision of different levels of service where possible. Before entering a separate agreement with you, we will provide you with an estimate of the costs to supply you with the service requested and advise you if the service that we have agreed to provide is below the standards set out in this contract.

…

3.2 Sewerage services

3.2.1 Supply of sewerage service

If your property is connected to our sewer system, we will supply you with sewerage services to meet a customer's reasonable needs for the discharge of domestic sewage except:

- *where we are entitled to discontinue supply under clause 6; or*
- *in the case of planned interruptions and unplanned interruptions, under clauses 3.4.2 and 3.4.3; or*
- *in the case of events beyond our reasonable control.*

…

3.2.4 Trade waste

You may discharge trade wastewater into our sewer system only if you have obtained our written permission and entered into an agreement with us.

We will give you our written permission and enter into an agreement with you only if we are able to accept, transport and process trade wastewater that you discharge in full compliance with applicable safety and environmental laws, the Operating Licence and the Act.

You can contact us to obtain further information on the guidelines and standards for a trade waste permission.

…

4.1 Responsibility to pay the account

You must pay us the amount of your account by the date specified, unless you have been overcharged or undercharged – see clauses 4.5 and 4.6.

…

6.6 Disconnection by a customer

You may disconnect your property from our sewer system or our water system provided that:

- *you have complied with all applicable health, environmental and local council regulatory requirements;*
- *you have given us information we may reasonably require;*
- *you have given us 10 days written notice; and*
- *the disconnection is undertaken by a licensed plumber or drainer and conducted in accordance with plumbing, drainage or other regulations or standards that may apply.*

On disconnecting your property, we may continue to charge you a service availability charge. You may apply to us to be exempted from this charge.

…

14.1 Termination of this contract

This contract will terminate between us and you if you cease to be covered by this contract as described in clause 2.2.

The termination of this contract does not affect any rights or obligations of you or us that accrue prior to termination.

14.2 Variation of this contract

We may also vary this contract as permitted by the Act.'

57 Division 8 of Pt 6 of the *Sydney Water Act* deals with fees and charges. The key provisions for present purposes are:

'60 Fees and charges generally

(1) The Corporation may impose:

(a) fees and charges for or in connection with any service or thing supplied or provided by the Corporation in the exercise of its functions under this Act, and

(b) without affecting the generality of paragraph (a)—availability charges and stormwater drainage area charges.

…

(3) The Corporation may impose any such fees and charges by customer contracts or by any other means. A fee or charge that is imposed by a customer contract cannot be altered except in accordance with the customer contract or an operating licence.

…

(5) An operating licence may regulate the imposition of any fees and charges, and in particular may provide for any or all of the following:

(a) specified fees and charges must not be imposed or must cease being imposed,

(b) specified fees and charges must be imposed,

(c) specified fees and charges may be imposed by customer contracts only.

…

64 Availability charges

(1) The Corporation may and, if so required by an operating licence must, require the owner of land that is not connected to a water main or sewer main owned by the Corporation and available for connection to pay an availability charge.

…

(5) Without limiting the generality of section 60 (5), the Corporation must cease imposing availability charges if an operating licence so requires.'

58 Sydney Water's fees and charges are subject to regulation by IPART. Clause 8 of the Operating Licence provides as follows:

> *'Sydney Water must set the level of fees, charges and other amounts payable for its Services subject to the terms of this Licence, the Act and the maximum prices and methodologies for Sydney Water's Services determined from time to time by IPART under the IPART Act.'*

IPART currently sets maximum prices for domestic and trade waste sewage services, as well as for recycled water supplied at Rouse Hill. A new pricing determination has recently been issued and commenced on 1 October 2005. Residential households pay a flat annual fee for sewage collection, while trade waste customers pay management and volumetric charges which reflect the amount and content of trade waste discharged into the sewer. The maximum availability charge for sewerage services has been set at zero. The previous pricing determination also set maximum prices for sewer mining at zero, with sewer miners required to pay the capital costs of interconnection. However, there are no maximum prices for sewer mining under the new determination. IPART has said that a negative price may be appropriate where costs are avoided as a consequence of sewer mining. It will review sewer mining charges as part of its forthcoming review of recycled water prices.

59 While the prices determined by IPART are expressed as *maximum* prices, s 18(2) of the *Independent Pricing and Regulatory Tribunal Act 1992* (NSW) (the *IPART Act*) provides:

> *'The approval of the Treasurer must be obtained if another Minister, an official or an agency fixes (or takes action to fix) the price below the*

maximum price determined by the Tribunal or calculated in accordance with the determination of the Tribunal.'

60 Certain performance and service standards relating to sewerage services are laid down in the Operating Licence. IPART undertakes an annual audit of Sydney Water's compliance with the Operating Licence. Under the Operating Licence, Sydney Water also has various annual reporting obligations to IPART, covering matters such as compliance with the sewage overflow standard, its performance against service quality and system performance and environmental indicators, progress in meeting the Environmental Plan and in meeting water re-use targets. It is also required to report to IPART at least once during the term of the Operating Licence on its asset management system, which IPART is required to audit.

61 Section 35 of the *Sydney Water Act* requires Sydney Water to enter into Memoranda of Understanding with each of the Water Administration Ministerial Corporation, the Department of Health and the Environment Protection Authority to form the basis for co-operative relationships with those regulatory agencies.

62 Sydney Water is also subject to additional environmental regulation under the *Protection of the Environment Operations Act 1997* (NSW) (the *POEA Act*) and the *Environmental Planning and Assessment Act 1979* (NSW) (the *EPA Act*). Each of its sewerage reticulation networks and sewage treatment plants are licensed under the *POEA Act*, and these licences contain numerous conditions relating, for example, to sewage overflows and pollution incidents, breaches of which may involve criminal liability.

Sydney's water supply

63 The potential for recycling sewage as reclaimed water is particularly significant in Sydney, which is suffering from a long term water supply and demand imbalance. The NSW Government's *Metropolitan Water Plan 2004* stated that consumption had been exceeding the safe yield from water storages for the preceding three years and the gap would increase over the next 25 years without action. This is said to reflect a reduced supply of water available from Sydney's major dam, as a consequence of global warming and prolonged drought, compared to projected population growth and the recognised need to increase environmental flows in the Hawkesbury-Nepean and other rivers to restore their health.

64 There have been a number of policy responses by Sydney Water and the NSW Government to the water shortage facing Sydney. On the supply side it is planned to divert water from the Shoalhaven and there is a proposal to build a desalination plant. On the demand side, various regulatory restrictions and initiatives have been introduced, including water use restrictions; the Building Sustainability Index (BASIX) scheme, which requires all new houses and apartments in Sydney to reduce their mains water consumption by 40 per cent through installation of water efficient fixtures and rainwater tanks or connection to a recycled water supply; the payment of subsidies for installation of water efficient fixtures and rainwater tanks; and establishment of the Water Savings Fund.

65 Historically, domestic water prices have been set below the long run marginal cost of supply and were not originally related to usage. Hence the pricing mechanism did not bring supply and demand for water into balance. Usage charges have been introduced and the most recent IPART price determination has substantially increased the proportion of charges made up of usage charges as compared to the fixed charge. Usage charges are now two tiered, increasing from $1.20/KL to $1.48/KL beyond usage of 400 KL per year for individually metered households. These prices reflect the long run marginal cost (LRMC) of bulk water supply, which has been estimated by IPART's consultants to be in the range of $1.20/KL to $1.50/KL, and are designed to encourage water conservation and deter the use of drinking water for discretionary purposes such as watering gardens.

66 Higher marginal prices for drinking water will make the use of recycled water for non-drinking purposes more attractive. The geographic area over which it is economic to supply recycled water is currently limited to a relatively small radius around a sewage treatment plant, but if the price increases to some degree with the increased price of drinking water, supply over greater distances will become more viable.

SERVICES SYDNEY

67 Services Sydney was established by Mr van der Merwe and Mr Feitelson in 1998 as an alternative approach to the Sydney Water Sewer Overflows Licensing Project (SOLP) studies in the 1990s and Sydney Water's *Water Plan 21*, published in October 1997, for the provision of water and wastewater services until 2020. *Water Plan 21* included major investment to upgrade sewage treatment and to reduce sewage overflows through major maintenance work. Services Sydney's alternative plan involved investment in major new

infrastructure to bypass old sewers and sewage treatment plants, intercepting and diverting sewage to a new high level sewage treatment and water reclamation plant.

68 Initially, Services Sydney entered into negotiations with Sydney Water to progress their plan under some sort of contractual arrangement. The two parties entered into Heads of Agreement in October 1999 to undertake two jointly funded pre-feasibility studies in relation to the proposal. These pre-feasibility studies reported favourably on the proposal, but Sydney Water subsequently terminated the Heads of Agreement. Services Sydney continued to develop their proposal independently and made further submissions to the NSW Government. By 2002 the proposal was termed *Sustaining the City*, but still involved the supply of sewage treatment and water reclamation services to Sydney Water. There was no proposal at this time to compete with Sydney Water for retail customers. At the end of 2003, the NSW Government notified Services Sydney that it would not be committing further resources to a consideration of Services Sydney's proposal.

69 Failing to win the support of either Sydney Water or the NSW Government, Services Sydney decided to add sewage collection services to its proposal, with the intention of competing with Sydney Water for customers. This was the genesis of the application to the NCC and now to the Tribunal.

70 Services Sydney's current proposal involves two stages. Both stages involve the construction of an interconnection tunnel which would connect with each of Sydney Water's three major reticulation networks and Services Sydney's sewage treatment plant. Sydney Water would transport the sewage from Services Sydney's customers to interconnection points, where it would be transferred into Services Sydney's pipe and transported to the sewage treatment works. Under the first stage, sewage would be treated to a secondary level and then disposed of. Various options for disposal were canvassed, including the possible use of Sydney Water's existing infrastructure or the construction of new infrastructure.

71 The second stage would involve treating sewage to a tertiary level and producing recycled water. The reclaimed water could be used for agricultural, industrial and domestic purposes and/or returned to rivers for environmental flows. Evidence before the Tribunal particularly focussed on the latter and the barriers to achieving such a plan, particularly the

need to obtain title over land for tunnelling, regulatory and licensing requirements and the various parties with whom Services Sydney would need to reach agreement.

72 Services Sydney also stated that it would be possible to further upgrade its plant to treat water to a potable standard, using reverse osmosis and ultraviolet techniques. This is not part of the current proposal, however, in recognition of consumer resistance to the use of recycled water for drinking.

73 Services Sydney stated a preference for implementing both stages of its proposal from commencement, but recognised that this will depend on their funding and ability to obtain relevant licences and approvals. It intends to charge comparable prices to Sydney Water and to compete for customers on the basis of having 'green' technology.

CONDUCT OF THE HEARING

74 As previously noted, the Tribunal's review of the Minister's decision is a re-hearing of the matter. Accordingly, the Tribunal was presented with fresh evidence and materials, as well as having available the NCC's recommendation and report to the Minister and submissions made to the NCC. The Tribunal is an administrative body, not bound by the rules of evidence. It can receive such material from such sources and in such manner as it sees fit.

75 At the initial directions hearing, counsel for the Premier of NSW, the designated Minister in relation to this application, indicated that he wished to intervene in the matter. He wished to explain his reasons for failing to make a decision; to make submissions regarding the regulatory changes and costs that would be required to facilitate access; to raise what were described as 'whole of government issues' relating to the industry; and to put before the Tribunal the IPART report, which the Premier had requested, reviewing the water and wastewater industries in NSW (see below), and if possible the NSW Government's response to it. Sydney Water supported the application to intervene. Sydney Water also requested that the matter not be heard prior to receipt of the IPART report. The Tribunal declined to delay the hearing to await receipt of the report, but as it turned out the directions resulted in the hearing coinciding with the expected date of the final report. In the event, the draft IPART report (*Investigation into Water and Wastewater Service Provision in the Greater Sydney Region* (the IPART Draft Report)) was received immediately prior to the hearing.

76 The Premier's application to intervene was declined on 6 April 2005. The Minister has a place in the statutory framework as the deemed decision maker but is not made a necessary party to the review by the statute. Sydney Water was the natural contradictor and played an active part in the proceedings. The presence of a natural contradictor relieved the need for the decision maker to play that role. The IPART report could be, and was, conveyed to the Tribunal without requiring the intervention of the Premier in the proceedings. To the extent that matters relevant to the NSW Government existed, but were not adequately covered by the parties to the review, the Tribunal could have been expected to seek assistance from the Premier. Further, there was no barrier to the Premier offering information to the Tribunal and applying for leave to appear on a limited basis as events unfolded, or indeed to him making a further application to intervene, if justified by new circumstances.

77 The IPART draft report was released on Friday 2 September 2005 and the hearing commenced on Monday 5 September 2005. As discussed below, the draft report made some recommendations regarding a proposed access regime to water and wastewater infrastructure. Receipt of the draft report caused Sydney Water to reconsider the grounds on which it would object to Services Sydney's application for declaration. After considering the draft report, Sydney Water supported the introduction of a state based access regime as proposed by IPART and accordingly narrowed the grounds for its objection.

78 The criteria in contention between the parties were already limited to s 44H(4)(a) and (f) of the Act (criterion (a) and criterion (f)), namely whether competition would be promoted in another market and whether declaration would be contrary to the public interest. Sydney Water now argued that the Tribunal should find that it is more likely than not that a state based access regime along the lines recommended by IPART would be introduced in NSW. This changed the nature and extent of Sydney Water's grounds for objecting to the application for declaration. The nature of the dispute under (a) was narrowed, with Sydney Water accepting the market definitions proposed by Services Sydney for the purposes of this application, but arguing that the boundaries of those markets were unclear. Their arguments under criterion (a) now focused on whether competition would be promoted in those markets. The dispute under (f) also changed, with Sydney Water no longer arguing that the costs of providing access would exceed the potential benefits, but arguing that the provision of access would require various other regulatory reforms and that a state based access regime, which

would deal with these issues in an integrated package, would be preferable to declaration under Pt IIIA of the Act.

79 As an initial threshold issue, Sydney Water contended that the Tribunal did not have jurisdiction to hear the matter because of the changing definition of the services for which declaration is sought. We have already dealt with this contention.

80 Prior to the hearing in this matter, the Tribunal received a submission from the Public Interest Advocacy Centre (PIAC). PIAC describes itself as an independent and non-profit legal and policy centre. PIAC undertakes work on access to essential services through its Utility Consumers' Advocacy Program, funded by the NSW Department of Energy, Utilities and Sustainability. The submission was limited to commenting on the potential impact on consumers of a declaration of the services under the public interest criterion (see below). The Tribunal has taken PIAC's submission into account.

81 The Tribunal heard evidence from six witnesses. Mr van der Merwe, a Director of Services Sydney, gave evidence in relation to the history of Services Sydney, its current plans, infrastructure requirements and costs, and the investigations and negotiations undertaken to date. Mr Freeman, General Manager of the Asset Management Division of Sydney Water, provided evidence in relation to Sydney Water's sewerage reticulation network, sewage treatment and disposal, its involvement in the supply of recycled water and the various regulations under which Sydney Water operates. He also gave evidence regarding practical issues associated with interconnection. Dr Hansen, General Manager of the Sustainability Division of Sydney Water, gave evidence regarding Sydney Water's sewer mining policy and its arrangements with SOPA for sewer mining and the supply of recycled water. Mr Law, an expert engineering consultant called by Services Sydney, provided evidence in relation to the technical viability of stage one of Services Sydney's proposals, technical aspects of sewage treatment generally and whether there is a basis for determining the sewage volume and pollution load contribution of particular users of Sydney Water's reticulation network.

82 Both sides called economic experts, who had previously filed reports. Services Sydney called Mrs Smith and Sydney Water called Dr Williams. Following the narrowing grounds of dispute between the parties, parts of the filed reports were not read. Both

witnesses were cross examined sequentially in the first instance. Following this, the Tribunal members asked a number of questions of both witnesses together. The evidence focused on whether declaration would promote competition in the agreed markets, and economic issues relating to the public interest. The Tribunal was assisted by this evidence.

83 IPART's Final Report was released after the conclusion of the hearing, on 29 November 2005. The Tribunal wrote to all the parties asking if they wished to make supplementary submissions arising out of the Final Report. Submissions were received from the NCC, Services Sydney and Sydney Water and the solicitors for the Premier of NSW provided a statement.

84 The Tribunal would like to acknowledge the assistance of the parties in the co-operative and expeditious manner in which the hearing was conducted and to the witnesses for their assistance.

THE IPART REPORT AND NSW GOVERNMENT RESPONSE

85 On 2 September 2005, IPART published the IPART Draft Report. The Final Report was anticipated to be available by 31 October 2005 but was in fact published on 29 November 2005. The Report followed a NSW Government request that IPART:

> *'… investigate and provide advice on possible pricing principles and alternative arrangements, including possible private sector involvement, for the delivery of water and wastewater services in the greater Sydney metropolitan area, with a view to making recommendations for providing these services in the most efficient, effective and sustainable way.'*

86 While there are some differences between the draft and final reports, the overall direction of the two reports is not fundamentally different. IPART expressed general support for increasing competition in Sydney's water and wastewater industry, with a focus on promoting dynamic efficiency, including through the introduction of access-based competition:

> *'The fundamental need in Sydney's water industry at present is innovation and the provision of new supply sources. To this end, the Tribunal has sought competitive reforms where the potential benefits are likely to be in the form of dynamic efficiency gains …, including increased innovation and more efficient use of water resources.'*

87 The Report examined three areas of potential reform: competitive sourcing; access; and structural reform. The Report placed particular emphasis on the first two. It did not recommend that Sydney Water be vertically or horizontally separated at this time, but recommended that work continue to examine the potential costs and benefits of structural reform.

88 In relation to competitive sourcing, IPART recommended a move to 'outcomes-based procurement'. In the Final Report, IPART looked specifically at the practice of sewer mining, which it was considered would likely feature prominently among competitive sourcing proposals and recycled water projects in general. IPART recommended that the NSW Government establish a regulatory framework for sewer mining, in order to ensure its efficient uptake. IPART will also be reviewing sewer mining charges as part of its forthcoming review of recycled water pricing.

89 Of particular relevance to the current matter, the Report supported the introduction of access-based competition:

> *'The Tribunal believes that access-based competition has the potential to improve the efficiency and effectiveness of service provision in Sydney's water and wastewater industry. In general, where it is feasible, competition can provide stronger incentives for efficiency and innovation than regulation.'*

90 IPART recommended the introduction of a state based access regime to govern access to Sydney Water's water and sewerage reticulation systems. It recommended a cautious 'adaptive management' approach to access and competition until the demand for access becomes clearer. The proposed access regime would follow a negotiate/arbitrate model and would be available for infrastructure which meets relevant criteria, with IPART suggesting the application of criteria contained in Pt IIIA of the Act. The Draft IPART Report had proposed that initially only large customers be exposed to competition. The Final Report reconsidered this issue and recommended that access be available to compete for all customers, but that all of the costs associated with a new entrant should be covered by that entrant's business proposal and not spread across Sydney Water's asset base, to be recovered from Sydney Water's existing customer base or be the subject of a price determination by IPART. It was recommended that appropriate regulatory obligations be placed on both incumbents and new entrants through a licensing or authorisation regime. IPART further recommended the use of the efficient component pricing rule (ECPR), under which the

incremental costs of providing access would be added to and Sydney Water's avoidable costs would be deducted from retail prices, to determine access prices.

91 The advantages of a state based access regime were said to be that it would allow for an integrated approach to regulatory reform and Government policy in the industry and the use of a single regulator for retail and access prices as well as service standards. State based regulation was also considered to be appropriate in the absence of a national market for urban water and wastewater services. The use of ECPR pricing would allow 'postage stamp' pricing to be maintained, under which residents are charged the same for sewage services regardless of their location. It can also be implemented in the absence of information about the unbundled costs of Sydney Water's services. A major problem identified with ECPR based access pricing is that it may do nothing to erode monopoly profits. However, IPART considered this issue to be of less concern in the water and waste water industry because final prices, from which ECPR access prices are calculated, are regulated and IPART recommended that this regulation continue.

92 The NSW Government indicated at the time of release of the Final Report that it would be accepting all of its recommendations, including the introduction of a state based access regime to water and wastewater services. The statement later provided to the Tribunal spelled this out in detail. That statement is set out in full because of the importance that it assumes:

> *'1. As announced by the Premier's press release and in the NSW Parliament on 29 November 2005, the NSW Government has approved development of a State-based access regime for services provided by means of significant water and waste-water infrastructure, consistent with the recommendations of the Independent Pricing and Regulatory Tribunal ("IPART") in its Final Report Investigation into Water and Waste-Water Service Provision in the Greater Sydney Region (November 2005) (the "Final Report").*
>
> *2. All 22 of the recommendations in IPART's Final Report were endorsed by the NSW Government.*
>
> *3. Consistent with those recommendations, and as foreshadowed in the Premier's press release of 29 November 2005, the NSW Government is now committed to introducing a State-based access regime with, among other things, the following characteristics:*
>
> *a. The regime will cover water and waste-water infrastructure which exhibits natural monopoly characteristics such as transportation services and interconnection. Coverage will not*

be limited to large customers but will cover both business and residential customers.

b. The regime will be drafted so as to enable the future inclusion of water and waste-water infrastructure beyond the greater Sydney metropolitan area, where it meets the relevant natural monopoly criteria.

c. The regime will be based on a negotiate-arbitrate model, with access via commercial negotiations given primacy.

d. The regime will be drafted with a view to ensuring that it will be an "effective access regime" in accordance with section 44G(3) of the Trade Practices Act 1974 *(Cth) and the Competition Principles Agreement.*

e. As such, the regime will be drafted to address the concerns, such as the need for enforcement provisions and accounting separation, and the other matters raised by the National Competition Council in its review of the IPART Report.

f. The regime will be administered by IPART, which will also retain responsibility for retail pricing regulation.

4. It is expected that a draft of the regime will be prepared by mid-2006. The NSW Government intends and expects to finalise and implement the regime toward the end of 2006.

5. To facilitate this timing, responsibility for coordinating the implementation of the IPART recommendations has been allocated to the Metropolitan Water Directorate within The Cabinet Office. The Premier has recently relocated the Directorate to his administration in recognition of the importance of progressing reforms of the water and waste-water industries in Sydney. An inter-agency Working Group chaired by The Cabinet Office has been established to oversee the drafting of the regime and to recommend complementary regulatory reforms by mid-2006. Appropriate resources have been allocated to these tasks in central government and in relevant agencies. This timing is further facilitated by the comprehensive consultation and investigations undertaken by IPART to produce their Final Report.

6. The State-based access regime will have significantly greater breadth than the services which were the subject of the National Competition Council's ("NCC") Final Recommendation of 2004. The NSW Government intends and expects that the regime will cover all of the services that were the subject of the NCC's Final Recommendation, and considerably more.

7. Given the NSW Government's commitment to the development of an effective water and waste-water access regime, it is not in the public interest for this regime to be duplicated at the Commonwealth level. Duplication between regimes would waste government resources and be contrary to the intent of the Trade Practices Act.

8. The NSW Government intends and expects that the State-based access regime will be developed so as to constitute an effective access regime

in accordance with section 44G(3) of the Trade Practices Act *and the Competition Principles Agreement. To ensure that that happens, the NSW Government will consult with the NCC before finalising and implementing the regime.*

9. At the same time as the NSW Government develops the State-based access regime, it will, in accordance with IPART's Recommendation 17, undertake a review of the current legal and regulatory framework and will modify that framework as necessary to:

> *"ensure appropriate regulatory obligations are placed on incumbents and new entrants through a licensing regime or authorisation regime to protect customers and the public interest in relation to ensuring security of supply, ensuring water quality and protection of public health, managing environmental impacts, developing, maintaining and extending water and sewerage services, addressing potential effects on customer contracts, and allocating responsibility for managing emergencies and national security matters" (Recommendation 17).*

10. The NSW Government will also undertake a legislative review to identify and, where warranted, remove any impediments to water and waste-water competition (Recommendation 9).

11. Consistent with the recommendations in IPART's Final Report, the first guiding principle for the development of the access regime and the cognate legislative and regulatory framework will be that "no service provider or activity should have an adverse impact on public health, safety or the environment" (IPART Final Report, p. 86).

12. Water and waste-water services are essential services which are vital both to health, and to economic, environmental and social well-being. The Premier believes that any access regime applying to water and/or waste-water services can only be in the public interest if it is implemented in a manner which gives primacy to public health, safety, environmental and other broader public interest concerns.

13. Providing access to the water and waste-water services provided by Sydney Water's infrastructure will create new markets in upstream and downstream activities where there currently are no competitive markets. It is imperative therefore, that any access regime be developed concurrently with, and so as to be concordant with, the development of an appropriate legislative and regulatory framework for these new markets, to ensure protection of the broader public interest. The development of this framework is a matter which, constitutionally, is within the province of the State.'

ASSESSMENT OF THE APPLICATION AGAINST THE STATUTORY CRITERIA

93 As noted earlier in these reasons, the matters in dispute before the Tribunal were confined to criteria (a) and (f). However, the Tribunal must be satisfied of all the matters

listed in s 44H(4)(a)–(f) before it can declare the services. Accordingly, we now proceed to address each of these matters in turn. Before going to the individual criteria, however, there are some preliminary matters which require discussion, because they may have implications for the way in which the Tribunal approaches the assessment of several of the criteria, and particularly criteria (a) and (f).

The meaning of 'access' in s 44H(4)(a) and (f) of the Act

94 Services Sydney and Sydney Water contended for alternative definitions of the word 'access' in s 44H(4). Services Sydney contended that:

> *'the word 'access'… is to be given its ordinary English meaning. A reference to 'access' to a service in such a context is a reference to a right or ability to use that service.'*

95 Sydney Water contended that:

> *' "access" in the context of criterion (a) means access by mechanisms contemplated by the access regime prescribed by Part IIIA, that is, the creation of a right of access on negotiated or arbitrated terms and conditions determined by the ACCC under Part IIIA.'*

The NCC agreed with Sydney Water's approach.

96 The Tribunal has previously adopted the approach to this question advocated by Sydney Water. In *Re Sydney International Airport*, where this was not a contentious issue, the Tribunal stated that (at 40,775):

> *'In reaching a view as to whether increased access would promote competition, the Tribunal must look to the future on a similar basis to the way it looks at the authorisation provisions, namely the future with or without declaration.'*

Similarly, criterion (f) was interpreted in terms of whether declaration would be contrary to the public interest (*Re Sydney International Airport* at 40,795-40,796).

97 In *Re Duke Eastern Gas Pipeline Pty Ltd* (2001) ATPR 41-821 (*Re Duke*), which concerned parallel provisions under the Gas Code, the interpretation of the term was contentious: Duke contended that access to the pipeline was in fact already available and

therefore criterion (a) was not satisfied. The Tribunal rejected this approach and confirmed that (at 43,061):

> *'… the question posed by criterion (a) is whether the creation of the right of access for which the Code provides would promote competition in another market. The enquiry is as to the future with coverage and without coverage.'*

Again, criterion (d), which is the Gas Code equivalent to criterion (f) under s 44H(4), is similarly interpreted in terms of 'coverage', not access in fact (at 43,072). (See also *Re Virgin Blue Airlines Pty Limited* [2005] ACompT 5 at [130]–[144].)

98 Although the correct conclusion is debateable, the Tribunal does not propose to depart from those prior rulings. However, it is not at all clear that there is any significant practical difference between the alternatives for the purposes of this case. The significance of the distinction, for both criteria (a) and (f), is said to rest principally on the status of the IPART recommendations. That issue, however, is, at most, a counterfactual with which access (as properly understood) is to be compared.

99 In previous decisions, the Tribunal has emphasised that achieving access under Pt IIIA of the Act is a two stage process (*Re Australian Union of Students* (1997) 147 ALR 458 at 468; (1997) ATPR 41-573 at 43,961; *Re Sydney International Airport* at 40,755; *Re Virgin Blue Airlines Pty Limited* [2005] ACompT 5 at [66]-[69]). The first stage is the process of declaration by the Minister, or this Tribunal on review, which provides a right to negotiate terms and conditions of access to the service(s), or to have them arbitrated by the ACCC. This has been described as 'opening the door' to access (*Re Sydney International Airport* at 40,755). Declaration in itself does not amount to the grant of access to the service. Whether any particular party is able to or chooses to go through the door depends on the second stage, the determination of the actual terms and conditions of access, either by negotiation or through arbitration by the ACCC (s 44V(3) of the Act).

100 The legislative framework clearly establishes a two stage process for access. It is unnecessary and unhelpful for the Tribunal to speculate as to the possible terms and conditions of access when considering the question of declaration. In the first place, terms and conditions of access may be determined through negotiation rather than arbitration, although it is true that the expected outcomes and time delays associated with arbitration will affect the bargaining position of the parties. In terms of any arbitrated outcome, s 44X of the

Act requires the ACCC to take account of the direct costs of providing access to the service, among other factors, but does not impose any particular pricing regime on the ACCC when it is conducting such an arbitration. All that can be assumed at the time of considering declaration is that the parties and the regulator will act reasonably and that there will be access accordingly on appropriate terms. (See also *Re Virgin Blue Airlines Pty Limited* [2005] ACompT 5 at [136] and [150]).

Would it be uneconomical for anyone to develop another facility to provide the service(s)? [s 44H(4)(b) of the Act]

101 While this criterion appears second in the statutory list of which the Tribunal must be affirmatively satisfied before it can declare the service(s), it logically precedes an assessment of criterion (a). Only if the facility which provides the services will not be duplicated, does the question really arise as to whether those services are essential inputs required to enter related markets, and hence whether access will promote competition.

102 The Tribunal has previously taken the view that an assessment of criterion (b), consistent with the words of the statute, requires it to focus on the duplication of the facility or facilities used to provide the service(s) which are the subject of the application for declaration; rather than on the wider question of the duplication of facilities to service the market, which would include consideration of substitutes (*Re Sydney International Airport* at 40,791; *Re Duke* at 43,060 and 43,071). Use of the term 'natural monopoly' in relation to criterion (b) may therefore be somewhat misleading, since the term 'monopoly' is generally used in relation to a market. In many cases, because of the nature of the infrastructure assets which attract applications for declaration, the service will constitute the extent of the market, but this will not always be the case. Indeed, it was a matter of some dispute in both *Re Sydney International Airport*, in relation to competition from the proposed Sydney West airport, and *Re Duke*, in relation to competition from the Moomba–Sydney pipeline. By focusing on the service(s) at issue, the assessment of criterion (b) is simplified and issues of market definition and competition are left to criterion (a), which only needs to be assessed if the relevant facility meets criterion (b).

103 In *Re Duke*, the Tribunal articulated the relevant test as follows (at 43,071):

> *'We agree with the submissions of the NCC that the "test is whether for a likely range of reasonably foreseeable demand for the services provided by*

means of the pipeline, it would be more efficient, in terms of costs and benefits to the community as a whole, for one pipeline to provide those services rather than more than one." '

104 In the current matter, the relevant facilities are 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. Sydney Water's sewerage reticulation networks are the only facilities which are currently providing transport services between customer premises and potential interconnection points; and the only networks supplying or potentially supplying interconnection services.

105 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.

106 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(2)).

Will access to the services promote competition in at least one market other than the market for the service(s)? [s 44H(4)(a) of the Act]

107 This criterion is one of the two matters which were the focus of disagreement between the parties and their respective economic experts, albeit that the grounds of that dispute narrowed somewhat as the matter proceeded. The criterion requires the Tribunal to determine, first, that at least one separate market exists, generally upstream or downstream from the service(s); and second, that there would be a causal connection between access to the services and promotion of competition in that market or markets.

Market definition

108 Market definition involves a process of identifying the buyers and sellers who constrain the pricing and output decisions of the firm. Section 4E of the Act provides that the term market 'when used in relation to any goods or services, includes a market for those goods or services and other goods or services that are substitutable for, or otherwise competitive with, the first-mentioned goods or services.' As the Tribunal said in *Re Queensland Co-operative Milling Association Ltd* (the QCMA case) (1976) 8 ALR 481 (at 517); (1976) ATPR 40-012 (at 17,247):

> *'A market is the area of close competition between firms or, putting the matter a little differently, the field of rivalry between them. … Within the bounds of a market there is substitution – substitution between one product and another, and between one source of supply and another, in response to changing prices … So a market is the field of actual and potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive.'*

109 While product and geographic substitution will often be the focus of argument in Pt IV matters, this is less often so in Pt IIIA matters. The focus here tends to be not on the *dimensions* of the market, as defined by substitution, but on the *existence* of *separate* markets from the market for the service. In other words, at which functional levels in the supply chain do markets occur?

110 Consistent with the QCMA case, a market exists where there are actual or potential transactions for goods or services. Actual transactions can be observed, but how do we determine whether there are potential transactions, which is generally the issue that arises for consideration under Pt IIIA, at least as regards the market(s) for the service(s)? This question arose first under s 46 in the High Court decision *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Co. Ltd* (the Star Picket Fence Post case) (1989) 167 CLR 177, which concerned a refusal to supply on reasonable terms a product known as 'Y-bar', which was needed to make star pickets for rural fencing. The question arose as to whether there could be a market for or including Y-bar, when there was no actual trade in the product. The High Court found that there was. Deane J said (at 196) that:

> *'… a market can exist if there be the potential for close competition even though none in fact exists. A market will continue to exist even though dealings in it be temporarily dormant or suspended. Indeed, for the purposes of the Act, a market may exist for particular existing goods at a particular*

> *level if there exists a demand for (and a potential for competition between traders in) such goods at that level, notwithstanding that there is no supplier of, nor trade in, those goods at a given time – because, for example, one party is unwilling to enter any transaction at the price or on the conditions set by the other.'*

111 In discussing this case, in *Market Definition Issues on Australian and New Zealand Trade Practices Litigation,* (1990) 18 ABLR 86 at 122, Professor M Brunt asked the question:

> *'A market is the network of actual and potential transactions between buyers and sellers of goods or services which are, or could be, close substitutes. Under what circumstances, we may ask, would the potential for transactions not exist? Answer: when there are such efficiencies of vertical integration, as between Y-bar and star pickets, that market co-ordination between buyers and sellers is superseded by in-house co-ordination. There would, in such a case, be no functional split to create transactions between stages of production.'*

112 The Tribunal agrees with this approach.

The market for the service

113 In their original submissions and in the filed statements of the economic experts, there was a dispute between the parties as to whether it was appropriate to define a functionally distinct market or market(s) for the services for which declaration is sought. While the parties agreed that the critical issue was the relative costs of market transactions as compared to the costs of internal coordination within a vertically integrated firm, they disagreed as to the relevant test.

114 The parties abandoned this area of debate following release of the IPART Draft Report, when Sydney Water acknowledged that a separate market for the services could be created by way of access and hence accepted, for the purposes of this application, the separate markets propounded by Services Sydney. Nevertheless, the Tribunal must be satisfied of the existence of separate markets. However, in the circumstances, there is no occasion for a comprehensive consideration of the issue. Our reasoning can be relatively brief.

115 The purpose of establishing an access regime under Pt IIIA of the Act 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. The approach adopted to the identification of separate markets should be consistent with this purpose.

116 One approach to assessing efficiencies of vertical integration is to posit that where the transactions costs of market coordination between vertical stages of supply exceed those of administrative coordination within the firm, there will be no separate market for the service(s). However, a literal interpretation of that test could prevent the very benefits of competition in dependent markets, which Pt IIIA is designed to achieve, from being realised. It is not difficult to imagine a situation where the coordination costs within a vertically integrated firm are less than the costs of market transactions for a particular service; but where there exists a more cost efficient potential entrant to an upstream or downstream dependent stage of the supply chain, who can more than offset the additional transactions costs with their superior efficiency. Entry of such a firm would be pro-competitive and economically efficient, yet a narrow view of the test would have the consequence that no market for the service would be defined and hence there would possibly be no declaration and no entry. The community would be denied the very kind of benefits arising from competition which were envisaged by the report of the Independent Committee of Inquiry into Competition Policy in Australia on National Competition Policy (the Hilmer Report) and which underpin the access regime principles in Pt IIIA.

117 A broader approach, which asks whether the complementarities of vertical integration are such as to dictate vertical integration, would not preclude declaration and competition in these circumstances. This approach was generally adopted in the NCC's Final Report and is consistent with that adopted by the Tribunal in *Re Sydney International Airport* (at 40,772):

> *'Though in the past usually vertically integrated, track services and the running of passenger or freight trains can be, and increasingly are, provided separately. As such, they operate in functionally distinct markets, even though there is perfect complementarity between them. To put it another way, these complementarities do not appear to give rise to economies of joint production that dictate the services must be performed within the same economic entity.'*

118 An alternative, more precise, test could involve looking at some combination of both transactions costs and service delivery costs. If there was a demand for the service at a price which covered these combined costs, then a market could be said to exist.

119 In practical terms, the application of all of these tests in advance of declaration is difficult because it will not be possible to know with any accuracy, at that time, the extent of potential transactions costs and service delivery costs, in a situation where actual transactions have never taken place because of the existence of a vertically integrated monopoly.

120 In the present case the Tribunal is not satisfied that the costs associated with market transactions (with or without taking into account service delivery costs) are such, or conversely the efficiencies of vertical integration are such, that the existence of separate markets is precluded. There is no difficulty in accepting the existence of a market or markets for the services of transportation and interconnection.

The dependent markets

121 Services Sydney put forward three dependent markets:

(1) a sewage collection market;
(2) a sewage treatment market; and
(3) a recycled water market.

122 While Sydney Water accepted the existence of these markets for purposes of the application, they complained that 'the activities which are said to take place in the Dependent Markets are unclear. Services Sydney's approach to these markets has changed over time and uncertainty remains.' The Tribunal considers that the reason for this uncertainty lies in the erroneous approach to defining markets in terms of 'activities' rather than in terms of an area of close substitution between goods or services. As discussed above, a market exists where there are actual or potential transactions for goods or services. The confusion arises because in delineating the functional level of a market we are required to consider vertical efficiencies and transactions costs between vertically related activities. In this sense it may be said that market 'breaks' in the vertical supply chain, where actual or potential transactions occur, are determined by the *minimum set of activities* which an efficient firm would undertake. The activities themselves, however, do not define the market or the scope for substitution. Within a market it is both possible and commonly observed that firms with very different vertical structures compete by providing substitute products. In other words, we observe a range of vertical firm structures beyond the minimum set of activities which determine the existence of a market at any particular functional stage. Thus, for example, in

telecommunications markets we commonly observe resellers competing with vertically integrated incumbents and partially integrated players who combine unbundled inputs.

123 The issue is well illustrated in relation to the **sewage collection market**. The Tribunal has no difficulty with the concept of a market for sewage collection services. Transactions in this market already take place between virtually every household and business in Sydney and the monopoly supplier of those services, Sydney Water. It is a vertically integrated supplier, but that circumstance does not define the market. There was debate as to whether this market was a pure resellers market or whether it incorporated other elements in the supply chain. There is scope for resellers to compete in such a market, as well as partially integrated players who may combine elements of self supply with purchased inputs from other industry players, including Sydney Water. All these firms would be supplying 'sewage collection services' to households and businesses and there is no reason to suppose their services would not be close substitutes and hence in the same market.

124 The relevant geographic market did not receive much attention. Supply side substitution and complementarities seem to be of most relevance here, since consumers need sewage to be collected from their premises. As discussed earlier in these reasons, each reticulation network is a separate facility, which tends to limit the potential for supply side substitution and suggests the relevant geographic market will be similarly defined. However, for purposes of the current matter, whether the geographic market is relevantly defined separately for each network or on some broader basis is of no consequence.

125 There are also existing transactions in the **sewage treatment market**. Any supplier of sewage collection services, who is not a pure reseller, will need to obtain sewage treatment services in order to dispose of the sewage collected, assuming that environmental restrictions will not allow them to simply tip untreated sewage into rivers and oceans in the future. While Sydney Water has traditionally undertaken sewage treatment services itself, increasingly it looks to make efficiency gains by contracting out these services to the private sector. More generally, the economic literature suggests that contracting out of sewage treatment is an obvious place for the introduction of market transactions and competition in the sewage industry. The Gerringong/Gerroa sewage treatment plant and reticulation network is operated by Veolia Water under a design-build-operate contract with Sydney Water. Similarly, SOPA contracts out the operation of its sewage treatment and water reclamation services.

126 SOPA and other sewer miners are also actual or potential suppliers in this market. Sydney Water indicated its support for paying SOPA a positive price for the sewage treatment services it effectively provides to Sydney Water by charging SOPA a negative price for sewer mining, but that this has not been possible to date because the price for sewer mining was fixed at zero by IPART. Under the new IPART price determination, there is no maximum price for sewage mining and the IPART Final Report indicates that a negative price may be appropriate.

127 Finally, we turn to the **recycled water market**. This is defined by Services Sydney as a 'market for the provision and acquisition of water (both recycled and potable) for the range of uses for which recycled water is considered appropriate'. Again the Tribunal has no problem accepting the existence of a market for recycled water. According to the *Metropolitan Water Plan 2004,* recycled water use in Sydney has increased from 6.2 billion litres per year to 14 billion litres per year. As noted earlier, Sydney Water already supplies recycled water to households in local areas which have been fitted with a 'third pipe' for reticulation, as does SOPA. Sydney Water also supplies recycled water to recreational, agricultural and industrial users. Mr Freeman said that Sydney Water is always looking for commercial opportunities to supply recycled water.

128 It is generally accepted, and research suggests, that the Australian public is not yet ready to accept recycled water for drinking purposes, and current regulations do not permit it. Potable water is widely used for non drinking purposes, hence substitution possibilities appear to be asymmetrical. However, where recycled water is available, how close a substitute potable water is for it will depend on the relative price and consumer responsiveness to those relative prices. This, in turn, will depend on the user's location. The only regulated prices for recycled water are those at Rouse Hill, where usage charges are less than a quarter of the charge for drinking water. For SOPA's customers, price differentials appear to be smaller. Industrial, agricultural and other large users, such as golf courses, are subject to individual agreements. Sydney Water submitted that it is currently only economic to supply recycled water within a small radius of a relevant sewage treatment plant.

129 Other major potential customers for recycled water would be bulk water suppliers, such as the Sydney Catchment Authority. If treated to a sufficiently high level, recycled

water could be returned to the potable water supply and/or used for environmental flows in rivers. Indeed this is a component of phase two of Services Sydney's business plan.

Will competition be promoted in any of the dependent markets?

130 While Sydney Water ultimately accepted the existence of the dependent markets contended for by Services Sydney, they did not accept that access to the service by declaration would result in the promotion of competition in any of those markets.

131 Before turning to the specific arguments raised in this matter, we must address the question of what is meant by the term 'promote competition' in s 44H(4)(a) of the Act. The Tribunal has expressed a view in the past that 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.

132 Thus in *Re Sydney International Airport,* the Tribunal stated (at 40,775):

> *'The Tribunal does not consider that the notion of 'promoting' competition in s.44H(4)(a) requires it to be satisfied that there would be an advance in competition in the sense that competition would be increased. Rather, the Tribunal considers that the notion of "promoting" competition in s.44H(4)(a) involves the idea of creating the conditions or environment for improving competition from what it would be otherwise. That is to say, the opportunities and environment for competition given declaration, will be better than they would be without declaration.'*

and:

> *'The purpose of an access declaration is to unlock a bottleneck so that competition can be promoted in a market other than the market for the service. … that is to say it is concerned with the removal of barriers to entry which inhibit the opportunity for competition in the relevant downstream market. It is in this sense that the Tribunal considers that … if the conditions or environment for improving competition are enhanced, then there is a likelihood of increased competition that is not trivial.'*

133 This approach was confirmed in *Re Duke*. After citing the relevant passage from *Re Sydney International Airport*, the Tribunal said (at 43,061):

> *'The Tribunal* [in *Re Sydney International Airport*] *concluded that the TPA analogue of criterion (a) is concerned with the removal of barriers to entry which inhibit the opportunity for competition in the relevant downstream market. It is in this sense that the notion of promotion of competition involves a consideration that if the conditions or environment for improving competition are enhanced, then there is a likelihood of increased competition that is not trivial. We agree.'*

134 Sydney Water submitted that *Re Duke* strengthened the test in *Re Sydney International Airport* such that there needs to be a real likelihood, as opposed to a trivial one, of increased competition - that there must be a **material** increase in competition. We do not agree that there was any intention to change the test in *Re Duke*. (See also *Re Virgin Blue Airlines Pty Limited* at [145]–[162].) Indeed, there are little, if any, practical differences between the descriptions 'not trivial', 'real' and 'material' in this context.

135 It must also be borne in mind that this is but one of the statutory criteria. Questions of degree can be considered under criteria (f) and there is also a residual discretion vested in the Tribunal (*Re Sydney International Airport* at 40,796). 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 (cf *Rural Press Ltd v Australian Competition and Consumer Commission* (2002) 118 FCR 236 at 274; (2002) ATPR 41-883 at 45,113-45,114; *Rural Press Ltd v Australian Competition and Consumer Commission; Australian Competition and Consumer Commission v Rural Press Ltd*, (2003) 216 CLR 53 at 73, (2003) ATPR 41-965 at 47,589-47,590; *Universal Music Australia Pty Ltd v Australian Competition and Consumer Commission* (2003) 131 FCR 529 at 590; (2003) ATPR 41-947 at 47,385).

136 The issue as to whether access would promote competition in the dependent markets has perhaps assumed greater importance in this matter than it has in previous matters which the Tribunal has considered. There are two principal reasons for this. First is the existence of other entry barriers, particularly regulatory barriers, into the dependent markets. Second, and somewhat related, the business plan of the proponent Services Sydney was extremely

ambitious and faced many potential problems other than gaining access to the services for which declaration was sought. However, it is important to bear in mind that once a service is declared it is not only the applicant who can negotiate access and seek to have the ACCC arbitrate the terms and conditions of access if required. Once a service is declared, any other potential entrant has the same rights available. We must consider whether the conditions for *competition* will be promoted, not whether any particular *competitor* will be promoted by gaining access to the service(s). However, there must be some real prospect of entry into the dependent market within a reasonable time for competition to be promoted. A time scale that is reasonable will vary from market to market, and is of some significance in this case. It may be accepted that, if entry into the market is prohibited and likely to remain prohibited, then the removal of another barrier to entry would not promote competition as required.

137 While we must address whether competition would be promoted in each of the markets separately, most of Sydney Water's arguments are relevant to all three dependent markets. Accordingly, we will address these issues at a general level first. These arguments fall broadly into four categories:

(1) the fact that access to the services has never actually been requested or refused and that the exercise of market power by Sydney Water is prevented by regulation;

(2) the likely creation of a state based access regime as recommended by IPART;

(3) the viability of Services Sydney's proposal; and

(4) the problems posed by the multitude of other regulatory barriers to entry.

The last two issues are related, since the regulatory barriers are also relevant to the viability of the project.

138 Sydney Water argued that it has never been requested to provide access to the services and hence that access has never in fact been refused. This was not challenged. Access to the interconnection service is already provided to sewer miners. Related to this argument, it was claimed that Sydney Water cannot effectively exercise its market power because it is required to operate efficiently and its prices are regulated by IPART.

139 In *Re Duke*, the Tribunal addressed the question of whether criterion (a) even comes into play unless access is either unavailable or restricted as a matter of fact. The Tribunal rejected the argument (at 43,060-43,061):

> *'The object of the Code, and its structure, make it clear that criterion (a) does not have as its focus a factual question as to whether access to the pipeline services is available or restricted. Put in that way, the question would not take sufficient account of the terms on which access is offered. Rather, the question posed by criterion (a) is whether the creation of the right of access for which the Code provides would promote competition in another market. The enquiry is as to the future with coverage and without coverage.'*

(See also *Re Virgin Blue Airlines Pty Limited* [2005] ACompT 5 at [138]–[139]). We agree with this approach. The fact that Sydney Water might provide access on unilaterally determined terms and conditions is not the same as providing a right to negotiate terms and conditions which can be determined by ACCC arbitration where negotiations fail. The existence of criterion (e) underlines this approach.

140 As discussed earlier in relation to criterion (b), Sydney Water's sewerage reticulation networks are 'natural monopolies' in the sense that it would be uneconomic to duplicate them for the provision of the services for which declaration is sought. There was also no suggestion that any other facility or facilities could provide a substitute service. Nor is potential competition a constraint. Accordingly, as the owner of those reticulation networks, Sydney Water has market power in the supply of the services, which are provided by means of those facilities. It has the power to charge monopoly prices, to refuse access to those services or to discriminate on terms and conditions of access. It would be in its interest to do so where this would deter competition and the erosion of Sydney Water's revenues in dependent markets. Access to the interconnection service is currently provided to sewer miners, but there is no right to arbitrated terms and conditions and there is no access to transportation.

141 While IPART regulates final prices to consumers, it does not currently regulate access prices. Sydney Water is required by s 21 of the *Sydney Water Act* to operate efficiently, but it was agreed by both economists that this requirement refers to cost efficiency and not to allocative efficiency, even assuming such a requirement could be effectively enforced. More generally, regulation is always a second best alternative to genuine competition.

142 There was no real examination of the potential impact of s 46 of the Act upon this issue. Even if it might have some relevant effect, it is a very blunt instrument and not comparable in operation to the opportunity for access pursuant to Pt IIIA of the Act.

143 The second issue affects the counterfactual of the future without access by declaration, against which the criterion of promoting competition in a future with declaration must be assessed in relation to all the relevant markets. Sydney Water urged the Tribunal to conclude that it was more likely than not that a state based access regime will be introduced. Given the IPART recommendations and the acceptance of them by the NSW Government, it was argued, that would give all the access required to promote competition. The Tribunal does not accept that the possibility, or even the probability, of an alternative access regime of uncertain shape emerging in the future is to be regarded as the equivalent of access by declaration for the purposes of assessing promotion of competition. That circumstance needs to be considered in relation to other criteria.

144 We turn next to the question of the viability of Services Sydney's proposal, putting aside, for the moment, regulatory barriers to entry. Sydney Water argued that it was highly speculative, with clear technical and financial impediments to its success. Further, it was argued that Services Sydney has made only limited investigations as to the necessary licences, approvals and agreements that would be required to implement its proposal. Absent any other potential access seeker, the prospects of promoting competition, it was said, could be no more than trivial.

145 Services Sydney argued that it could not be expected to have developed detailed final plans when access has not been available. It should be recalled that Sydney Water was initially interested in pursuing an earlier version of the proposal, which included the same site for a sewage treatment plant. It was submitted that the evidence established the technical and financial viability of its proposal to the necessary level. In the alternative, Services Sydney argued that the financial viability of the applicant for access is irrelevant to the assessment of criterion (a), because the right to negotiate access will be available to anyone if the service(s) are declared, not just the applicant. Declaration is concerned with improving the environment for competition rather than the prospects of any individual competitor as adopted by the Tribunal in *Re Sydney International Airport* (at 40,758-40,759).

146 Sydney Water submitted that what the Tribunal said in *Re Sydney International Airport* on this point can be distinguished from this case. It argued that the distinction is between the financial viability of any particular *firm*, which was at issue in *Re Sydney International Airport* and the financial and technical viability of a particular *project* or proposed business plan, irrespective of the financial resources available to any individual firm which might be considering undertaking the proposal. In other words, if a particular entry plan would be technically impossible or would not be remotely likely to yield an acceptable financial return, then the project would not be viable regardless of the financial resources available to the firm to invest in it. It was argued that Services Sydney's proposal is neither technically nor financially viable and that since there are no other examples of competition in sewage collection services around the world, there can be no expectation that unlocking the door through declaration of the services would result in anyone walking through it.

147 We will first consider the Services Sydney proposal. There was evidence led by both sides as to the technical and financial viability of Services Sydney's proposal. Mr Law and Mr Freeman both gave evidence as to the technical issues inherent in the proposal. Both witnesses were in broad agreement that the plan would require further work to finalise the technical engineering requirements. In our opinion, the evidence did not prove that it was not technically feasible. We note that pre-feasibility studies conducted by Connell Wagner Pty Ltd and Rolff Environmental Pty Ltd in 2000, pursuant to the 1999 Heads of Agreement with Sydney Water, supported the technical and financial feasibility of Services Sydney's plan in its earlier permutation as a sewage treatment and possible water recycling project.

148 The evidence as to the financial viability of the current plan was rather more equivocal. The Tribunal was shown a financial plan prepared by First Australian Capital Pty Limited for Services Sydney in relation to the NCC's consideration of this matter. While this plan purported to demonstrate that the proposal was financially viable, it was no more than a conditional endorsement, since it depended upon many assumptions, including an unknown and unspecified access price, and some uncertainty about capital costs. The Tribunal does not share Sydney Water's scepticism as to the funding methodology proposed, in particular as to the suggestion that a developer would carry some risk of such an ambitious construction project, delivering a 'turnkey' asset to Services Sydney. This type of arrangement is by no means out of the question for a major construction project. There are, however, questions

which remained unanswered as to the source of funding for the project. That is not surprising, having in mind that the project is hypothetical in the absence of access to Sydney Water's sewerage network.

149 The financial plan also depends on Services Sydney achieving a large market share. While a proposal to supply a 'green' product for the same price as Sydney Water currently charges may be attractive to consumers, it will still need to overcome customer inertia. Services Sydney provided survey evidence showing support for Services Sydney's earlier proposal. While it indicated that 72 per cent of people were willing to pay more for the service, it also indicated that 60 per cent were worried that rates would be increased to pay for the proposal. Because the proposal did not involve retail competition with Sydney Water at that time, people were not asked about their willingness to switch suppliers. Furthermore, what people say they will do and what they actually do are often quite different. There were other criticisms of the survey.

150 One of the greatest hurdles to Services Sydney realising its plan is the need to acquire the means to effect substantial tunnelling and then have continuing access in order to maintain the facilities. Gaining the right to tunnel under land owned by numerous private and public parties would seem to be remote without powers of compulsory acquisition and access. There is little chance of any significant new sewerage reticulation facilities being created by a purely private party. The general provisions for resumption in New South Wales are the *Land Acquisition (Just Terms Compensation) Act 1991* (NSW) and the *Public Works Act 1912* (NSW). Neither has application to the compulsory acquisition of property rights by a private party. However, public/private partnerships for the development of infrastructure are now commonplace. It is not possible to rule out a structure being developed whereby a project of this type could be achieved if the possibility of access became a reality.

151 It can be concluded that Services Sydney's proposed entry plan is extremely ambitious, but we cannot be satisfied that it is not either technically or financially viable. Certainly it has been pursued tenaciously over many years and at considerable expense by Mr van der Merwe. He has had both supporters and detractors along the way, and Sydney Water has been both. Ambitious projects may bring significant economic progress if they succeed, or they may bring financial disaster for those involved if they fail. Prediction as to success or failure from outside is notoriously difficult. Some parties will choose to enter a

market, although others (perhaps most others) do not see the opportunity or predict failure. Some of those entrants may fail, some may not. That is the essence of the competitive process. There are dangers in a regulator attempting to predict the commercial future and in picking winners (or, in this case, losers).

152 As we noted previously, the issue is not limited by Services Sydney's plan, but includes whether entry to one or more of the dependent markets by any potential competitors will promote competition. There are many very substantial engineering and construction companies in business in Australia and overseas with the technical and financial resources to undertake the engineering and construction involved. There are many private and public authorities in Australia and overseas with experience in designing and running sewerage and water plants and systems and other similar utilities such as gas and electricity. There are numerous financiers specialising in providing finance for infrastructure projects. It is not difficult to envisage the formation of a consortium of such parties to put forward a scheme of the type proposed by Services Sydney or a variation of it that would be extremely attractive to a State government pressed for funds to develop infrastructure. Furthermore, it is not difficult to imagine that Services Sydney might find a place in such a consortium. Such a consortium would be in a powerful position to remove any barriers to entry apart from access. The only such party to come forward to date has been AGL Limited in a modest fashion. That is not surprising. It is only because of the persistence of Mr van der Merwe that such a possibility has relatively recently emerged in relation to what was hitherto regarded as a closed shop.

153 It is also possible to conceive of alternative entry plans which do not involve the large scale of a proposal like that of Services Sydney. For example, a new entrant might enter the sewage collection market in only one of the three reticulation networks and set up its own sewage treatment and water recycling plant adjacent to the main trunk sewer and also close to one or more major industrial users of water. As the price of water increases, the viability of shipping recycled water over greater distances will also increase. Or an entrant may not engage in recycling at all but simply compete for retail sewage collection services and process its own sewage, possibly more efficiently and/or to a higher standard than Sydney Water currently does, disposing of it in some other way, possibly simply as a 'trade waste' customer of Sydney Water. On a smaller scale, SOPA and other potential sewer mining operations, which are not currently profitable because they cannot access customer revenue

for sewage collection services, could access the declared services in order to compete for sewage collection services in their areas of operation, potentially increasing the viability of such projects.

154 In short, the scope for entry to the markets, absent any absolute regulatory barriers to entry, is real and cannot be described as trivial. Such regulatory barriers, however, are of particular significance in the current matter.

155 We turn to the argument that entry to the markets is effectively prohibited. As discussed earlier, Sydney Water currently operates in a highly regulated environment, whereby it is required to meet numerous legislative and licensing requirements relating to operating and service standards, health standards, planning permission, environmental licensing and price regulation. Any new entrant would equally have to meet some regulatory requirements. This much was acknowledged by both parties.

156 Sydney Water argued that the height of the regulatory barriers to entry was such that the prospects of entry being realised was entirely speculative and did not meet the threshold of more than trivial. It was not suggested that there is any express blanket statutory prohibition upon entry into any of the dependent markets, rather it was contended that entry to the sewage collection market is effectively barred in practice by legislation. It was argued that the legislative and regulatory regime simply does not envisage entry, and that the Tribunal should not assume the necessary legislative and regulatory changes to facilitate it will be forthcoming. It was also contended that entry to all markets is practically prevented or seriously inhibited by the necessity to obtain various licences and permissions and by the absence of power to enter or acquire lands.

157 Services Sydney acknowledged that it would have to step through ‘a mine field’ of regulatory and other requirements before its proposal could come to fruition, but argued that none of these obstacles is insurmountable. It argued that competition is promoted by declaration as long as one barrier to entry is lowered, even if other potential obstacles to competition remain, as long as entry to the dependent market is not prohibited and that market is not itself a natural monopoly. It suggested that legislative amendment is unnecessary, but even if it is required, it argued there will still be a promotion of competition as long as the environment for competition is improved. The removal of one barrier to entry

may itself open up the possibility of further legislative changes to facilitate entry. The NSW Government, as signatory to the Competition Principles Agreement, has adopted 'competitive neutrality' principles for NSW Government businesses and would be expected to treat any proposal by Services Sydney, and any associated applications for licensing, on their merits. Sydney Water itself is required, by cl 11.3.1 of its Operating Licence, to comply with competitive neutrality policies and guidelines adopted by NSW.

158 The critical issue is whether the *Sydney Water Act* and other relevant legislation would allow the entry of a competing supplier of sewage collection services (and buyer of sewage treatment services), provided it could gain access to transportation and interconnection services. In the Tribunal's opinion, the answer is in the affirmative. Sydney Water has no statutory monopoly over sewage collection services, either explicit or implicit – indeed, its Operating Licence is expressed to be non-exclusive. Further, there is no obligation upon any householder to connect to Sydney Water's mains. There is no prohibition upon a householder contracting with a third party for the disposal of sewage. A third party is not prohibited from providing that service for reward.

159 An examination of the history of Sydney Water indicates that competition was contemplated at the time of corporatisation. The intention of the then government appears from the following passages in the Second Reading Speech (Hansard, NSW Legislative Assembly, 22 September 1994, pp 3630–3634):

> *'Why corporatise the Water Board? The current structure of the Water Board inhibits the organisation's performance. It is a barrier to* ***competition*** *and makes for conflicts of interest.*
>
> *Corporatisation involves picking up the* ***competitive forces*** *that apply to private companies and applying them to 100 per cent government owned organisations to make them more effective businesses.*
>
> …
>
> *The State Owned Corporations Act empowers the five key principles of corporatisation: clear objectives; managerial control; performance monitoring; rewards and sanctions; and* ***greater competition****.*
>
> …
>
> *To meet the significant demands of the past, we created* ***monopoly*** *providers of public services and built great cities. Our future and that of our children, lest we leave them with fewer resources and greater debt, is dependent on forcing utilities such as the Water Board to* ***compete*** *and lift their game.*
>
> …

> *This bill will create a level playing field so that the corporation is exposed to* ***competition and market forces****, the same as a company in the private sector. To date, the Water Board has reduced its operating costs, become more efficient and successfully prepared for competition by contracting out non-core activities and exposing Water Board business units to competition in the open market.*
>
> *This bill creates the opportunity for others to enter the corporation's area of operations to* ***compete*** *to provide services.*
>
> …
>
> *As a corporation, Sydney Water will be subject to Corporations Law, the Consumer Claims Tribunal and - most significantly for competition and to control monopoly position - the Trade Practices Act.'*
> [emphasis added]

160 The anticipated competition is reflected in the provisions of the Operating Licence, which is explicitly non-exclusive and which requires Sydney Water to comply with competitive neutrality policies and the Act. Subsequent revisions to the *Sydney Water Act* have changed the model of corporatisation, the management of water catchments and brought Sydney Water under the regulation of IPART, but have not changed the nature of the legislative regime governing sewage.

161 The *Sydney Water Act* essentially establishes Sydney Water as a provider of last resort for essential water and sewage services, where a failure to supply would have serious health and environmental consequences, imposing significant externalities across the economy. This is reflected in the duty imposed on Sydney Water to connect customers on request within its geographic area of operation and the deemed contract which then comes into existence. In practice, it has also been the *only* supplier of sewage collection services. This is because, without access to Sydney Water's reticulation network(s), a new entrant would need to duplicate a sewerage reticulation network. These networks are the facilities at issue in this matter, which we have already found to be uneconomical to duplicate. This is the critical barrier to entry into the sewage collection market and declaration would remove that barrier, facilitating competition, provided there are no other prohibitions on entry to the dependent market. The IPART Report, and the apparent acceptance of the thrust of it by Sydney Water and the NSW Government, are strong pointers to the inevitable dismantling of Sydney Water's vertically integrated monopoly of sewage services.

162 Once the barrier to entry associated with access to the services is overcome, the only major (statutory) obstacle to entry would appear to be the deemed contract provided for by s 55 of the *Sydney Water Act.* The only situations under which s 55 does not apply are where a sewerage connection is unauthorised (s 56) or where a customer has entered into an alternative contract with Sydney Water (s 57). At the moment, the new entrant's customers would not be relieved of the obligation to pay the regulated fee for sewage collection services to Sydney Water whilst remaining connected to Sydney Water's sewer. Thus, if the third party takes the sewage by virtue of interconnection, the customer would be liable for both fees. This is a practical barrier rather than a legislative prohibition.

163 That position is not likely to remain. It is not consistent with the spirit of the competitive neutrality principles or Pt IV of the Act. It is not consistent with the ability of a householder to disconnect from the Sydney Water sewer. IPART has set the theoretical availability fee in those circumstances at zero. IPART has noted the problem in its Final Report and is hardly likely to permit the anomaly to continue at the next price review, particularly as if a third party obtains access to the services then it can be assumed that Sydney Water will be properly remunerated for providing access to those services. As noted earlier, the prices determined by IPART are *maximum* prices. If a customer entered into a contract for sewage collection services with a new entrant, Sydney Water could reduce the price it charges that customer under the deemed contract to zero, but under s 18(2) of the *IPART Act* it would require the Treasurer's approval. This does not amount to a statutory prohibition. In any event, it is hardly likely that the Treasurer would refuse consent to waiver of the fee in these circumstances.

164 Sydney Water is required to comply with the NSW Government's *Policy Statement on the Application of Competitive Neutrality* (2002) under the terms of its Operating Licence. This policy is directed at ensuring the equal treatment of government and non-government competitors, including pricing goods and services in a competitively neutral manner, one of the benefits of which the Guidelines recognise to be 'the removal of potential barriers to increased market contestability'. Under the policy, IPART is charged with investigating competitive neutrality complaints that are referred by the Premier.

165 It has not been argued that Sydney Water has any statutory monopoly in the supply of sewage treatment services or recycled water. It has been argued that current legislation

would require various consents and authorities to be obtained for those necessary facilities to be constructed and for the activities to be conducted. That is correct. The same is also true of any activity involving the need for physical structures and risks to the environment. Indeed, it can be safely assumed that all relevant environmental and other impacts of any proposal would be dealt with in the course of obtaining necessary approvals.

166 We do not agree that there is any legislative prohibition that would prevent entry to any of the dependent markets within a reasonable time so as to preclude access to the services from promoting competition in those markets, such as is illustrated by the recent draft recommendation by the NCC in *The Lakes R Us Application for Declaration of Water Storage and Transport Services* (8 September 2005). In practice, Sydney Water has been the only provider of sewage collection services because a new entrant cannot economically duplicate the reticulation network. Access to the transportation and interconnection services would accordingly promote entry and, so, competition. New entrants will be subject to relevant planning, environmental and health regulations and licensing requirements. If it is considered necessary to further regulate new entrants through provision for operating licences similar to that of Sydney Water, this will require legislative change, and declaration may well tend to bring this forward.

167 It is clear enough from the foregoing discussion that the actual entry of competitors into such an entrenched structure, even on a modest scale, is likely to take a considerable period of time whilst all of the ramifications are worked through, State and municipal regulations considered, planning and feasibility studies done, approvals arranged, finance obtained, contracts let and construction completed. None of that could be seriously commenced until access to the services becomes a realistic possibility by declaration, or an effective State regime of access established. The process must start for there to be a finish. It is not possible to predict the shape of the competition that may emerge. The very threat of competitive entry into the market in the medium or long term will place competitive pressure upon the incumbent Sydney Water to alter its behaviour.

168 In short, we are satisfied that Sydney Water has market power in the market(s) for transportation and interconnection services, that entry into the dependent markets is not otherwise barred and that such entry is not precluded within a reasonable time frame. However, we also need to be satisfied that there is a causal connection between access to the

services and the promotion of competition in one or more of those markets. We will now address this connection in relation to each of the dependent markets.

169 We turn firstly to the **sewage collection** market. Once it is understood that this market includes more than just pure resellers, the causal connection between access to the services and the promotion of competition in this market is clear from the preceding discussion. Both economists agreed that resellers could enter the market without requiring access to transportation and interconnection services. Mrs Smith argued, and the Tribunal agrees, that such reseller entry would add very little to the competitive landscape of the sewage collection market. If, however, entry was to be based on putting together unbundled input services from different suppliers, possibly including self supply of some elements, then access to transportation and interconnection services would be necessary. Both Mrs Smith and Dr Williams agreed with this. Dr Williams was of the opinion that this type of entry was highly unlikely. This view was largely based on the viability, or lack thereof, of Services Sydney's proposal, an issue which we have already addressed. The need for access would be equally true for any other entry plan that involved the use of unbundled sewage treatment services, whether self supplied or acquired from a third party. Such an entrant would need to be able to transport the sewage from their customers' homes and businesses to the sewage treatment plant they plan to use. One would expect that it would need to construct a new sewer to connect the sewage treatment plant with Sydney Water's trunk main sewer and hence it would also need to access the interconnection service. Entry of this type may involve the injection of both price, product and service based competition. New entrants may compete on the basis of cheaper and/or more environmentally friendly treatment processes

170 The Tribunal is satisfied that declaration will promote competition in the sewage collection market.

171 Turning next to the **sewage treatment** market, Dr Williams pointed out that there is already competition either in or for the supply side of this market. Sydney Water can look to alternative providers of sewage treatment services if it decides to contract out those services, or to contract for the construction and operation of a new sewage treatment plant. Entry on the supply side of this market does not require access to a transportation and/or interconnection service. This was not disputed by Services Sydney. Rather its argument hinged on promoting competition on the *demand* side of the sewage treatment market. The

Tribunal agrees that competitive entry on the demand side of the market does require access to transportation and interconnection services: entry on the demand side of this market reflects non-reseller entry on the supply side of the sewage collection market, since sewage treatment is an input to sewage collection.

172 While it is the case that Sydney Water is currently a monopsony buyer in this market, it is less clear that Sydney Water can currently exercise substantial market power as a buyer. In the markets for sewage collection services, Sydney Water can exercise market power as a vertically integrated monopoly supplier, because consumers in their geographic sphere of operation have nowhere else to go. The demand curve is downward sloping, and probably quite steeply downward sloping in the case of sewage collection services, providing the discretion to 'give less and charge more'.

173 It is less obvious that they can exercise market power to 'buy less and pay less' as a buyer of sewage treatment services. This requires the supply curve to be upward sloping. While Sydney Water could exercise short term market power over captive suppliers, it would be expected that entry to any given geographic market which was captive to a single buyer would be contingent on the negotiation of a long term contract which provided for a market return on the assets invested and/or the transfer of ownership of the assets to Sydney Water. This is the case, for example, with the Veolia Water contract for the Gerringong/Gerroa sewage treatment plant and reticulation network and the operation contract with SOPA. Accordingly, the supply curve would not slope upwards in the long run and Sydney Water could not exercise buyer power. If it attempted to reduce prices below a competitive level, nobody would enter.

174 However, since the Tribunal is satisfied that competition will be promoted in the market for sewage collection services, it is not necessary for us to determine decisively whether competition would be promoted in sewage treatment services.

175 Finally we turn to the **recycled water** market. It was argued by Dr Williams and by Counsel for Sydney Water that entry into this market did not depend on access to the transportation and interconnection services. Again this was largely based on the opinion, not shared by the Tribunal, that such a market would be confined to resellers of recycled water. As with resellers of sewage collection services, it follows by definition that this type of entry

would not require access to transportation and interconnection services, as it only requires access to a bundled supply of wholesale delivered recycled water. As with sewage collection services, this type of entry would be likely to have only a limited impact on competitive outcomes in the market. The entrant would be limited to re-supplying the recycled water acquired from the incumbent monopoly at an unregulated price.

176 While resellers may have a place in the recycled water market, there is no reason to believe that entry would be limited to such players. New entrants who engage in sewage collection and treatment as a source of recycled water are likely to add more depth and variety to the competitive process. As discussed above, Sydney Water already operates in this market as a vertically integrated player, engaging in all stages of the 'water cycle' from sewage collection, through transportation, treatment and recycling. IPART's Final Report also raises the possibility that entry to the recycled water market could be based on the use of stormwater, which would not depend on gaining access to the sewerage reticulation system. While this type of entry is likely to add more depth to competition than resellers, potential competition through unbundled entry will be maximised if entrants are not restricted to any particular model.

177 While the scale of use of recycled water in Australia, and particularly in Sydney, is small and often localised, it seems likely to grow as the long term and increasing scarcity of drinking water is recognised, and particularly as it is reflected in regulated water prices. IPART's latest price determination will make the use of recycled water for non potable purposes, increasingly attractive. In addition, regulatory requirements, such as the BASIX scheme for new residential developments may also increase demand. These developments will likely make entry to the recycled water market more attractive. The NSW Government's Metropolitan Water Plan recognises the potential for recycled water to substitute for up to 80 GL of potable water a year by 2029 and the NSW Department of Infrastructure, Planning and Natural Resources (DIPNR) is currently leading a taskforce to develop a metropolitan strategy for recycled water. While the geographic area over which it is economic to supply recycled water may currently be limited to a relatively small radius around a sewage treatment plant, that area will be likely to increase as rising prices allow the recovery of more transport costs.

178 Any sort of entry plan based on simultaneous entry into the markets for both sewage collection services and recycled water, and either self supply or contracting out of sewage treatment services, would require access to the transportation and interconnection services. As in the sewage collection market, this type of entry is likely to add more depth to the competitive process than reseller entry, because it may provide the entrant with a superior cost base and/or a superior product, providing the basis for price and product based competitive initiatives. It would include the expansion of sewer mining operations, where joint provision of sewage collection services and recycled water facilitated the viability of these operations.

179 The Tribunal is satisfied that declaration will promote competition in the recycled water market.

Are the facilities of national significance? [s 44H(4)(c) of the Act]

180 In assessing the application against this criterion, the Tribunal is required to have regard to the size of the facility, the importance of the facility to constitutional trade or commerce or the importance of the facility to the national economy. Use of the word 'or' in the section means that as long as the facilities are regarded as being of national significance against any one of these measures, the criterion will be met.

181 There was no dispute between the parties before the Tribunal that the three sewerage reticulation networks are of national significance, although this had previously been a matter of contention before the NCC.

182 In terms of its size, the North Head reticulation network serves a population of 1.115 million people, covers 5,500 km and carries an average dry weather throughput of 313 ML per day. Equivalent figures for the Bondi reticulation network are 245 thousand people, 772 km and 130 ML per day; and for Malabar 1.490 million people, 6,800 km and 480 ML per day. In 1997, the three networks collectively accounted for over 30 per cent of all reticulation networks in Australia.

183 In terms of constitutional trade or commerce, neither the services themselves nor the dependent markets are directly involved in constitutional trade or commerce. However,

provision of these services is an essential input to many other industries connected to the networks which are involved in such trade.

184 The pervasive use of sewage services by households, businesses and industry connected to the three networks is also relevant to the importance of the activities to the national economy. Sydney is Australia's largest city in terms of population and economic activity, accounting for approximately 30 per cent of GDP. Furthermore, the provision, or rather the lack of provision, of sewage services can involve major externalities, with the potential to impose major environmental and health costs on the community and the economy.

185 The Tribunal is satisfied that the facilities are each of national significance.

Can access to the service be provided without undue risk to human health and safety? [s 44H(4)(d) of the Act]

186 There was also no dispute between the parties that access to the service could be provided without undue risk to human health and safety. Sydney Water is currently subject to extensive health and safety regulations, as discussed earlier in these reasons. Any new entrant would have to comply with similar requirements, and where there was a regulatory 'gap', it would be expected to be filled. Relevant issues which have been canvassed in the current matter include the possible injection of hazardous substances into the network, the management of wet weather and other overflows and provider of last resort responsibilities.

187 The possible injection of hazardous chemicals into the system by third party users does not seem to create any greater problems than those raised by the existing connection of trade waste customers to the network. Both may potentially inject hazardous substances into the network. As long as the relevant regulations and penalties apply to both, there is no reason to think the risk would be any greater with declaration.

188 As to wet weather and other overflows, these problems arise with a vertically integrated monopolist. While there would clearly be a need to allocate responsibility and costs associated with dealing with these problems between the access provider and the access seeker, these are problems which can in principle be dealt with under stage two of the access regime, when the terms and conditions of access are determined by negotiation or arbitration.

189 Sydney Water is currently the provider of both first and last resort in relation to sewage services. As discussed earlier, Sydney Water is required to connect anyone within their geographic scope of operations to their sewerage reticulation network on request. Once connected, that household or business is deemed to have a contract with Sydney Water. Declaration will not in itself change that situation. Whether this arrangement remains desirable for a competitive market is another question, but we note that provider of last resort responsibilities remain with the incumbent suppliers after water markets in England and Wales were opened up to competition.

190 The Tribunal is satisfied that access to the services can be provided without undue risk to human health and safety.

Is access to the service already subject to an effective access regime? [s 44H(4)(e) of the Act]

191 There is currently no access regime, effective or otherwise, that applies to the services for which declaration is sought. While Sydney Water has an access policy in relation to interconnection for sewer mining operations, it does not provide any right to negotiate or have arbitrated the terms and conditions of access, it is simply a unilateral offer from Sydney Water, which may be withdrawn or amended as it sees fit. Accordingly, the Tribunal is satisfied that this criterion is met.

Would access be contrary to the public interest? [s 44H(4)(f) of the Act]

192 This criterion does not require the Tribunal to be affirmatively satisfied that declaration would be in the public interest. Rather it requires that it be satisfied that declaration is not contrary to the public interest. It enables the consideration of the overall costs and benefits likely to result from declaration and the consideration of other public interest issues which do not fall within criteria (a)–(e). As noted earlier, Sydney Water did not pursue its original claim that the costs of providing access would exceed the benefits.

193 A number of detailed issues were raised for consideration in relation to criterion (f). However, the principal point was that declaration would be against the public interest because of the impending introduction of a comprehensive State based access regime that would be preferable in a number of respects to the regime triggered by declaration. That proposition is fully developed in the IPART Reports, the submissions of Sydney Water and the statement

on behalf of the NSW Government that has been set out in full previously. It is not necessary to repeat all of the arguments. It is relevant to consider at this point whether the state based access regime outlined in the IPART Report is capable of being developed into an effective access regime. The Tribunal sought the views of the NCC in this regard. The NCC notes that while a number of the features of the access regime proposed by IPART are consistent with cl 6 of the Competition Principles Agreement, other features required under cl 6 are not clearly endorsed, in particular accounting separation. Until a more detailed proposal is available, the NCC was unable to form a definitive view as to whether the IPART proposal would develop into an effective access regime. We agree.

194 We note that IPART's Final Report includes a recommendation that a Reform Implementation Plan be developed, including provision for consultation with the NCC in finalising a state access regime to take account of the criteria for an effective access regime. The Premier's statement to the Tribunal confirmed the NSW Government's intention to develop an effective access regime consistent with s 44G(3) of the Act. Nevertheless, at this stage there is nothing to guarantee that an effective access regime will be introduced in the future, or to indicate when it might be introduced. In the event that an effective state based access regime is introduced, it would be appropriate to seek a revocation of any declaration that exists. Revocation is dealt with by s 44J and s 44L. The existence of an alternative effective access regime would satisfy s 44J(2). Whilst revocation depends upon a recommendation by the NCC (s 44J(6)), the provisions of ss 44M, 44N and 44O ensure that, in practical terms, the NCC could not fail to so recommend in a proper case.

195 The current process commenced on 3 March 2004 with the application by Services Sydney to the NCC. That had been preceded by negotiations between Services Sydney and Sydney Water commencing in 1998. There has been ample time for the development of an effective access regime since 1998. The current process has been time consuming and expensive. If a case had otherwise been made out for declaration, it would not be appropriate to, in effect, abort this process against the hope that a satisfactory alternative regime will emerge. Nonetheless, we will consider some of the more important points that have been made in this context.

196 It is suggested that a State regime would provide for a unified system of industry regulation, including prices, access and service standards across the industry, and would

provide better co-ordination with State government policy matters. It is contended that access and the introduction of full retail contestability would require substantial legislative and regulatory changes in order to have a well functioning market. Issues which it was claimed would need to be dealt with included provisions for the licensing of third party service providers; vertical separation or ring fencing of Sydney Water's retail and network operations; technical aspects of the access arrangements; assigning responsibility for provider of last resort; assigning responsibilities for managing overflow events and other 'systemwide externalities'; amendments to environmental licensing and measures to deal with trade waste and criminal liability issues; customer service and marketing codes; the creation of an independent Ombudsman to deal with consumer complaints; maintaining a customer database and managing customer transfers. These changes require action by the NSW Government.

197 However, access from the customer is via the existing interconnection with the existing network so that the practical status quo remains – there is no change to what occurs in practice. A new entrant will be subject to planning, health and environmental regulations and licensing requirements in relation to its own activities. Thus, no health and safety or other policy issue arises in relation to the collection and transportation of sewage by means of an interconnect access regime that would require any additional regulation. Many issues, such as dealing with overflows and the regulation of trade waste should be capable of resolution through the terms and conditions of access.

198 If further legislative and regulatory changes, such as vertical separation, operational licensing of new entrants and changes to the criminal liability regime, are considered necessary, then the NSW Government can make those changes, but there is no gap in the regulatory system which would create a danger to public health or the environment and thereby make new entry contrary to the public interest. The NSW Government may elect to adopt minimal changes to ensure that new entrants must meet the same operating licence standards as Sydney Water, but keeping responsibilities for the management of systemwide issues and provider of last resort with Sydney Water. Indeed this is the approach suggested by IPART in relation to systemwide planning responsibilities and backstop supply of water, at least until the potential demand for access becomes known. A similar approach has been adopted in England and Wales in relation to the new access regime for water.

199 Similarly, it is not clear that access and competition would require the establishment of any new centralised market administrator. Access to the sewerage reticulation system will not require the same exact balancing of inputs and outputs at five minute intervals that underpins the role of the National Electricity Market Management Company (NEMMCO) in the electricity industry. As with systemwide and provider of last resort responsibilities, management of the customer database, to ensure that everyone receives and pays for sewage services in order to prevent potentially significant externalities arising from non provision, could remain with Sydney Water.

200 While retaining responsibilities for systemwide externalities, provider of last resort and management of the customer database with Sydney Water may not be the ideal solution, it does not involve anything that can be said to be contrary to the public interest. If the NSW Government decides to make further changes to facilitate effective access and competition, that is a matter for it to deal with.

201 In a somewhat related argument, PIAC submitted that competition could, perversely, result in higher prices being charged to consumers in order to create 'headroom' for competition to develop and to allow Sydney Water to recover the costs of preparing for competition. We see no reason why the introduction of competition would necessitate prices rising above efficient levels. Indeed, IPART's Final Report indicates that it does not intend to allow any costs associated with the introduction of competition to be passed through to Sydney Water's customers. As previously noted, domestic water prices have traditionally been set below the long run marginal cost of supply. This situation has been addressed by the most recent IPART price determination. Charges for water and sewage services may well have to increase further to address long term problems of under charging, but such increases would have nothing to do with the introduction of competition.

202 PIAC also argued that the introduction of competition could result in the cost of any 'stranded assets' being passed on to consumers in regulated prices. Such assets would include, for example, under utilised sewage treatment plants. Whether this is the case will depend on the method chosen to determine access prices and whether such assets are retained in the regulatory asset base on which IPART bases its retail price determinations for Sydney Water. If, for example, ECPR access pricing was adopted, the cost of stranded assets would not be 'avoided' and the access charge would contribute towards them, but there would be no

reason to increase Sydney Water's regulated retail prices. If, on the other hand, the access price only reflected the cost of assets used in the transportation and interconnection services, Sydney Water would be left to cover the cost of stranded assets. Whether these could be recovered from consumers, however, would in part depend on the pressure of competitive pricing from the new entrants that have created the stranded assets problem. If those new entrants have more cost efficient sewage treatment technology, Sydney Water may be unable to recover the cost of its stranded assets from consumers without losing even more of them and increasing the problem.

203 Sydney Water currently uses 'postage stamp pricing', whereby residential customers pay a uniform price for sewage collection services irrespective of their location or the costs of sewage treatment. If uniform retail prices were maintained but access prices for the transport and interconnection services were non-uniform, this would create incentives for 'cream skimming' entry, whereby new entrants targeted low cost customers, leaving Sydney Water to supply services to the higher cost customers. This would be unsustainable and would likely result in the unwinding of postage stamp pricing. One response to this issue is that postage stamp pricing is inefficient because prices do not reflect the true cost of the services, providing poor incentives for the efficient allocation of resources.

204 However, there are strong equity concerns with variable pricing and the NSW Government remains committed to postage stamp pricing. PIAC stated that:

> *'Sewage services are an essential service and residential customers cannot absent themselves from the wastewater market. Postage stamp pricing reflects long-standing community concerns with affordability of sewage as an essential service and the equity of its pricing. It ensures that the community shares the cost of providing an efficient and safe sewage network.'*

205 It is the NSW Government's prerogative to determine whether or not postage stamp pricing should be maintained. However, we can see no reason why the maintenance of postage stamp pricing is not compatible with declaration. As long as access prices do not vary with the location of the customer, there would not be any incentive for cream skimming. This could be achieved either through the use of ECPR based pricing, as recommended by IPART, or through some other average cost approach, including an average building block cost approach. As discussed earlier, these are matters to be dealt with at the second stage of the access process, when the terms and conditions of access are negotiated or arbitrated.

206 PIAC also argued more generally that the benefits of competition would be focused on the more affluent sections of the community. Based on experience in other industries, they argued that new entrants would target their prices and marketing at those customers who were the least expensive to serve. However, the Tribunal has no reason to believe that experience in the electricity industry in this regard will be replicated in the sewage industry, which does not involve the same discretional consumption as electricity. Furthermore, if the Government makes a policy decision to subsidise such high cost customers, there are mechanisms that enable this to be done explicitly and transparently under a competitive access regime.

207 Services Sydney argued that the environmental benefits of their proposed business model constituted a positive public benefit which would arise from declaration. As noted above, criterion (f) does not require a positive finding of public benefit, only that declaration is not contrary to the public interest. Furthermore, declaration would not just provide access to Services Sydney. Other potential entrants may have quite different business plans with little or no environmental benefits. To the extent that the entry of third party competitors may provide greater incentives for innovation through the use of more environmentally friendly sewage treatment processes and increased supply of recycled water, this has already been factored into the assessment of criterion (a).

208 The Tribunal is satisfied that declaration would not be contrary to the public interest.

CONCLUSION

209 The Tribunal is satisfied that the application meets all the criteria for declaration. There is no occasion to exercise any residual discretion not to declare (*Re Sydney International Airport* at 40,796).

Period of declaration

210 Services Sydney requested that the services be declared for a period of fifty years. This period would be consistent with the NCC's recommendation. That recommendation was based on the substantial nature and long life of the assets which a new entrant, other than a pure reseller, would need to invest in. Such assets could include sewage treatment and

water reclamation plants and connecting sewers. It was argued that a period of fifty years was required to provide the necessary business certainty to secure investment in new entry.

211 Sydney Water contends, firstly, that 50 years is a purely arbitrary period apparently chosen to ensure that Services Sydney makes profits and, secondly, that any declaration should be for a very limited period of time in view of the forthcoming introduction of an effective State based access regime.

212 The likelihood of the facilities by means of which the services are provided being duplicated within 50 years and a competitive service becoming available are extremely remote. While technical change in sewage treatment and water reclamation processes is likely, the need for access to transportation and interconnection services to carry sewage from customers' premises to the competing treatment plants is likely to remain. Investors in new treatment and reclamation plants, which are expected to provide many of the dynamic gains from competition, will require the certainty of long term access arrangements before committing funds to the planning and implementation of such projects.

213 There is the possibility of an effective State based regime emerging over the next few years. Given the State based nature of the facilities it is possible that that could be an appropriate outcome, to be preferred to federal regulation. If there were a limited period of declaration, sufficient to enable assessment of any State based regime, it is arguable that application could be made for a further declaration pursuant to Div 2 of Pt IIIA at the expiration of the period of declaration.

214 The better view is that, if an effective access regime were established by the NSW Government, steps would be taken to revoke the declaration. That being so, a lengthy period of declaration is appropriate. Access needs to be certain for a sufficient period to enable capital to be invested by new entrants. The facilities are unlikely to be either duplicated or superseded by new technology in the foreseeable future. If that did occur, or if for any other reason the conditions for declaration no longer exist, then revocation of the declaration would be available (s 44J(2)). In our opinion, a declaration for 50 years from today's date is appropriate.

I certify that the preceding two hundred and fourteen (214) numbered paragraphs are a true copy of the Reasons for Ruling herein of the Australian Competition Tribunal:

Associate:

Dated: 21 December 2005

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Counsel for the Public Interest Advocacy Centre:	RJ Wright SC (5 September only)
Date of Hearing:	5, 6, 7, 13, 14, 19, 20 September 2005
Date of Orders:	21 December 2005