

15 April 2009

Dr Ron Ben-David  
Chairperson  
Essential Services Commission  
Level 2, 35 Spring Street  
Melbourne VIC 3000

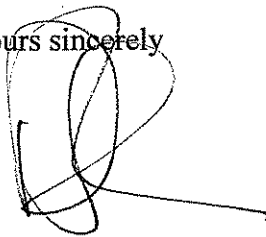
Dear Dr Ben-David

Please find attached Melbourne Water's submission responding to the Essential Services Commission's Issues Paper setting out the matters it will consider in its Inquiry into an Access Regime for Water and Sewerage Infrastructure Services. Thank you for the opportunity to make this submission.

Melbourne Water would welcome the opportunity to discuss the key points in the submission with the ESC.

If you have any enquiries regarding the submission, please contact Claire Preston, our Pricing and Regulation Manager, on 03 9235 1456.

Yours sincerely



**ROB SKINNER**  
**MANAGING DIRECTOR**

# Inquiry into an access regime for water and sewerage infrastructure services – ESC Issues Paper

Melbourne Water's submission – April 2009



# Table of contents

Executive summary	1
1 Nature and design of an access regime	3
Overview	3
Light handed access regulation	3
State based access regime	4
2 Infrastructure to be covered by an access regime	10
Overview	10
Criteria for access	10
Infrastructure types	10
3 Access pricing	16
Overview	16
Pricing principles for third party access	16
Regulatory guidance on prices	17
Access pricing methodologies	18
4 Water quality and other non-price terms and conditions	19
Overview	19
Water	19
Sewerage	22
Existing regulatory requirements	25
5 Other legislative, regulatory and co-ordination issues	26
Overview	26
Licensing framework	26
Information requirements	27
6 Access and future water industry reforms	28
Appendix 1	29



# Executive summary

Melbourne Water welcomes the opportunity to respond to the Essential Services Commission's (ESC) Issues Paper setting out the matters it will consider in its Inquiry into an Access Regime for Water and Sewerage Infrastructure Services.

Melbourne Water supports a light handed approach to access regulation for the water industry in Victoria, particularly in the early stages of any regime's development. This reflects the absence of any clear demand for third party access, as well as uncertainty in regard to the broader industry reform program. Such an approach will ensure the costs of regulation do not exceed the benefits.

Third party access is one mechanism for facilitating increased upstream and downstream competition. Melbourne Water considers that in addition to focusing on how to deliver competition, it will also be important to examine the key issues of what might be the nature, extent, costs and benefits of competition in these markets. An appreciation of these factors is necessary to design a fit for purpose access regime.

Melbourne Water is a part of the vertically disaggregated water industry in metropolitan Melbourne and operates within an existing regulatory framework, overseen by the ESC, to provide the metropolitan retailers, as well as Western Water and Gippsland Water, with access to its infrastructure services. Melbourne Water has also privately negotiated terms and conditions of access to its infrastructure services. Melbourne Water has done so because it has a commercial incentive to maximise the utilisation of its assets (i.e. utilise spare capacity), and its customers have benefited as a result.

While Melbourne Water favours continued private negotiation, if a formal access regime is to be introduced, it considers that this would best be achieved via a state based negotiate / arbitrate model. Consistent with a light handed and staged approach, under such a regime services eligible for declaration should be identified at the outset but there should be no upfront coverage declarations or access undertakings. Declaration should be determined on a case by case basis if private negotiations around an access request fail. In the event that agreement cannot be reached through negotiation, Melbourne Water suggests arbitration by the regulator as the mechanism for dispute resolution, with a limited right to merits review.

In relation to the infrastructure controlled by Melbourne Water, it considers that services eligible for declaration should include water and sewerage transfer infrastructure (including within transfer system service storages and treatment

facilities). These services could subsequently be subject to a coverage declaration or an access undertaking if access requests cannot be addressed through private negotiation. However, Melbourne Water does not believe that it is necessary for an access regime to apply at all to its water harvesting and seasonal storages, or the treatment facilities at these storages, or its sewerage treatment plants.

The issue of access pricing is a central consideration for any access regime. Melbourne Water recognises the importance of establishing pricing arrangements which are transparent and which provide guidance and a degree of certainty to industry participants and access seekers about the broad terms that will accompany any request for access, and the scope that exists to negotiate. Melbourne Water is also of the view that the pricing arrangements associated with a future access regime should be flexible to cater for varying access requests and changes in the nature of the system and its operation.

Third party access will raise important operational issues for water businesses, including how water quality, environmental, and health and safety requirements are met by the access provider and access seeker. While these issues are not insurmountable, they will require detailed consideration to ensure that there is no reduction in the quality of water and sewerage services provided. In this regard, it will be important that the access provider has the ability to manage the risks they will ultimately bear. Inclusion in the access regime of a clear process to enable these risks to be well understood, and for appropriate non-price terms and conditions of access to be developed, will be essential.

A licensing framework, in conjunction with the process outlined above for establishing non-price terms and conditions, will assist in managing the potential risks associated with entry by third parties. In particular, a licensing framework will help address the risks associated with services supplied by new infrastructure owned and operated by third party entrants, as distinct from the risks associated with supply via existing infrastructure owned by the water businesses. Licensing applications should be reviewed by the Minister for Water, following recommendations from the ESC, the Department of Sustainability and Environment (DSE) and other relevant stakeholders.

# 1 Nature and design of an access regime

## Overview

Melbourne Water considers that at this stage a light handed approach to access regulation is appropriate for the water industry in Victoria, particularly in the absence of any clear demand for third party access. This will ensure the costs of regulation do not exceed the benefits. While Melbourne Water favours continued private negotiation, if a formal access regime is to be introduced, it considers that this would best be achieved via a state based negotiate / arbitrate model. Consistent with a light handed approach, under such a regime services eligible for declaration should be identified at the outset but there should be no upfront coverage declarations or access undertakings. Declaration should be determined on a case by case basis if private negotiations around an access request fail.

## Light handed access regulation

Melbourne Water is a part of the vertically disaggregated water industry in metropolitan Melbourne and operates within an existing regulatory framework, overseen by the ESC, to provide the metropolitan retailers, as well as Western Water and Gippsland Water with access to its infrastructure services. In the past, Melbourne Water has also privately negotiated terms and conditions of access to its infrastructure services.<sup>1</sup> It does not have incentives to restrict access to its infrastructure services.

Melbourne Water believes that further requests for access to its infrastructure services are likely to be limited to particular examples. This would be consistent with the experience in other water markets where third party access regimes have been introduced (e.g. NSW and the England and Wales). Given this, at least in the short to medium term, Melbourne Water believes that private negotiation could be used to establish appropriate terms and conditions for any such requests.

While Melbourne Water favours continued private negotiation of terms and conditions of access, it recognises that the Victorian Government announced in July 2008 that it would develop an access regime to promote competition in markets upstream and

---

<sup>1</sup> For example, Melbourne Water and Southern Rural Water have negotiated terms and conditions for the transfer of Southern Rural Water's water from the Thomson Reservoir, to a point of interconnection with City West Water.



downstream from the natural monopoly infrastructure. Melbourne Water considers that the ESC's objective under the *Water Industry Act 1994* to ensure, wherever possible, that costs of regulation do not exceed the benefits, is of critical importance in determining the scope and design of any access regime, particularly given demand for access in the short to medium term is likely to be limited.

Initially this should involve a light handed approach, to reduce the up front costs of regulation absent any clear demand, while still providing a framework for access to infrastructure in the event there is such demand.

There are a number of existing precedents for light handed regulation. For example, under the national gas access regime, pipelines are subject to several different levels of regulation, ranging from no regulation through to 'light handed' and 'full' access arrangement regulation. The NSW Water Access Regime also provides for a form of light handed regulation. With some changes to reflect the different regulatory and structural features in Victoria, Melbourne Water generally supports such a regime.

## State based access regime

In NSW, the Government has favoured a state based regime that is tailored specifically to the NSW water and sewerage infrastructure services and that allows for a more integrated approach to industry regulation, including the use of a single regulator for retail and access prices, as well as service standards.

Victoria could similarly benefit from a state based regime (as opposed to a national access regime<sup>2</sup>) and the ESC would generally be well positioned as the regulator in Victoria.<sup>3</sup> The services Melbourne Water provides that are most likely to attract access requests (such as its water and sewerage transfer infrastructure) are already declared and prescribed under the *Water Industry Regulatory Order* and subject therefore to existing economic regulation by the ESC. As a result, the ESC has developed a significant degree of expertise in relation to the water industry and its associated pricing issues.

Melbourne Water considers that a state based access regime would allow consistency of regulation across access and other economic regulation. A light handed and staged approach to a state based access regime could also be implemented in a manner that

---

<sup>2</sup> A generic national access regime is currently provided by Part IIIA of the *Trade Practices Act 1974*.

<sup>3</sup> A state based regime would require regulatory co-ordination between states, particularly in relation to infrastructure in the Murray Darling Basin in northern Victoria.

is mindful of recent and planned developments in relation to access to water infrastructure services in other jurisdictions.

## Key principles for a state based regime

The ESC has asked in its Issues Paper what factors it should take into account in designing a third party access regime for water and sewerage infrastructure services. Melbourne Water considers that a fit for purpose regime should be based on the following key principles:

- Minimal regulatory costs: any access regime should be designed taking into account the likely costs and benefits of access.
- Certainty: any access regime should provide water businesses and access seekers with certainty about the services that are likely to be regulated, how long the regulation will apply for and the process for establishing price and non-price terms and conditions where access is provided.
- Flexibility: any access regime should have the capacity to evolve over time in response to developments in the water industry (e.g. technological developments or changing water policy). The access regime should reflect the level of demand for access and should apply more developed procedures only where demand increases.
- Review: any access regime should be subject to periodic review, to ensure that it is achieving its objectives and for the regulator and the industry to understand where improvements are required.
- Supporting framework: any access regime should be supported by an appropriate legislative and regulatory framework.

Melbourne Water believes that these principles are consistent with the ESC's regulatory objectives. Melbourne Water agrees with the intentions of the ESC to ensure that the access regime is introduced in a carefully staged process with regard to checking that markets are operating effectively and not affected by unforeseen adverse consequences and that "*a state based access regime is flexible enough to remain appropriate and applicable to a range of different industry structures.*"

## Coverage of services

### Eligible Services

Melbourne Water considers that a state based access regime should first define the broad scope of the infrastructure services which might be covered by the access regime, i.e. which are eligible for declaration. Section 2 of this submission sets out which of Melbourne Water's infrastructure services it considers could be defined as eligible services to be covered by an access regime.

### Coverage declarations on a case by case basis

Within the framework of defined eligible services, Melbourne Water considers that coverage declarations should be determined on a case by case basis if private negotiations around an access request have failed.<sup>4</sup> This is consistent with light handed regulation, and in an environment where access requests are expected to be limited, avoids imposing unnecessary significant information or cost burdens on the access provider.

Melbourne Water does not believe that there is a need for declaration of particular services at the outset of a state based regime in Victoria. The situation in Victoria is very different to that in NSW, where a dispute regarding access to some of Sydney Water's services had resulted in declaration of those services under Part IIIA of the *Trade Practices Act 1974* prior to the state based regime being implemented. The NSW Government formed the view it was not necessary to assess those services again and they were deemed to be declared under the state based regime.

If and where private negotiations fail and an access seeker applies for declaration, the regulator's decision on declaration must be governed by clear criteria.<sup>5</sup> Melbourne Water considers criteria of the nature outlined by the ESC in its Issues Paper would be appropriate<sup>6</sup>:

- It would not be economically feasible to duplicate the service
- Access to the service is necessary to materially enhance effective competition in upstream or downstream markets
- The service is of significance in relation to the state or a particular region

---

<sup>4</sup> This enables private negotiations to occur and is consistent with the approach taken in the *Water Industry Competition Act 2006* in NSW.

<sup>5</sup> Melbourne Water also considers that these criteria can be applied more broadly to define the eligible services that could be subject to declaration or an access undertaking.

<sup>6</sup> Similar criteria exist in the *Trade Practices Act 1974* and also apply to the water industry in parts of NSW under the *Water Industry Competition Act 2006*.

- The safe use of the service by the person seeking access can be assured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist.

Melbourne Water also considers that although declarations would need to be in place for a certain period of time, they should be subject to scheduled periodic review, in addition to the right for parties to apply for revocation. Regular reviews allow for changes in market conditions, infrastructure capacity, technology and government policy.

### Option for voluntary access undertakings

Melbourne Water also suggests that the access provider should have the ability (but should not be required) to provide a voluntary access undertaking setting out the terms and conditions under which it is willing to provide access to a particular infrastructure service. The access undertaking would need to be accepted by the regulator and would take precedence over a declaration, consistent with other access regimes.

### Terms for access

#### Access agreements

Melbourne Water supports an access regime which encourages private negotiation of access terms and conditions.

As noted above, Melbourne Water has successfully negotiated such an agreement in the past and would enter into any future negotiations in good faith, with the intent of achieving a negotiated outcome on reasonable terms. Accordingly, it considers there is a need only for minimal regulatory requirements, if any, around negotiation protocols and procedures.

The ESC's Issues Paper notes that negotiations are likely to be between large access providers and smaller access seekers, at least in the early stages of a state based regime, and that a negotiation framework would need to address issues concerning information available to, and the bargaining power of, access seekers. As outlined above, Melbourne Water does not consider that a negotiation protocol is necessary and notes that it currently already publishes some of the information that could help an access seeker to negotiate terms and conditions of access. This includes its bulk supply agreements with the metropolitan retailers and the unbundled prices it charges the retailers, which are already determined by the ESC using a cost of service approach.

However, if the ESC is of the view that an access regime does require a negotiation protocol, Melbourne Water considers that it should only be a set of guidelines that retain flexibility for negotiation and minimise the cost of complying with the protocol. High compliance costs will affect access providers and the small access seekers that the ESC wants to protect, and may even discourage such access seekers if not properly designed. Melbourne Water also considers it important that any negotiation protocol should allow the parties to agree to deviate and follow an agreed alternative approach (or timeline) for negotiations.

In the event that agreement cannot be reached, arbitration by the regulator, as discussed below, would be the mechanism for dispute resolution.

### Dispute resolution

Melbourne Water supports a regime which provides for arbitration by the regulator, specifically the ESC, of disputes of access terms. It considers that the ESC is generally well placed to make access decisions and has water industry experience as well as experience in implementation of other industry access regimes in Victoria. That said, independent technical experts would likely have a role to play in assisting the ESC on issues relating to water / sewage quality and network management.

ESC arbitration should occur within a clearly defined process and the regime should establish upfront the criteria to be used by the ESC in its arbitration. Melbourne Water considers the ESC should be required in particular to take into account:

- The legitimate business interests of the access provider
- The interests of existing access seekers
- Water quality and environmental requirements, health and safety requirements and public benefits
- Pricing principles (see Section 3 for further detail).

### Appeal rights

Melbourne Water notes that in NSW, declaration and arbitration decisions are subject only to judicial review. Given the significance of a decision to grant a coverage declaration, accept an access undertaking, or establish the terms and conditions of access, Melbourne Water considers that at least a limited form of merits based review should be available.

Melbourne Water considers that limited merits based review, in line with the provisions in the *Essential Services Commission Act 2001*, should apply to decisions

about whether or not to grant a coverage declaration or accept an access undertaking. In addition, limited merits review should apply in relation to arbitration of an access dispute. Melbourne Water considers that the *Essential Services Commission Act 2001* contains an adequate framework for a review mechanism that allows parties to effectively test the adequacy of the decision, without undermining the authority of the regulator as the key decision-maker, or certainty for access seekers and access providers (and any other affected third parties).

Melbourne Water therefore supports a regime where decisions are subject to review on grounds of bias, or whether the decision is based wholly or partly on an error of fact in a material respect, has not been made in accordance with the law, or is unreasonable having regard to all the relevant circumstances. Melbourne Water would support a reviewer with powers to affirm the initial decision, to set aside that decision, to vary the decision in accordance with the review body's finding, or to send the decision back for re-consideration by the initial decision-maker (with advice or recommendations from the reviewer).

Melbourne Water considers that any review should be based on the information before the initial decision-maker, with the review body able to request additional information as necessary. Melbourne Water would agree with allowing the initial decision to take effect pending the outcome of the appeal.

## 2 Infrastructure to be covered by an access regime

### Overview

Melbourne Water considers that the definition of eligible services in any state-based access regime needs to be tailored to the water industry and the relevant market characteristics in Victoria. In relation to the infrastructure controlled by Melbourne Water, it considers that there are grounds for the definition of eligible services to include water and sewerage transfer infrastructure (including within transfer system service storages and treatment facilities). These services could subsequently be subject to a coverage declaration or an access undertaking in the event that private negotiation is unsuccessful. However, Melbourne Water does not believe that it is necessary for an access regime to apply to its water harvesting and seasonal storages, the treatment facilities at these storages, or its sewerage treatment plants.

### Criteria for access

As noted in Section 1, Melbourne Water considers the following criteria to be appropriate for determining the services that can be the subject of coverage by a state based access regime:

- It would not be economically feasible to duplicate the service
- Access to the service is necessary to materially enhance effective competition in upstream or downstream markets
- The service is of significance in relation to the state or a particular region
- The safe use of the service by the person seeking access can be assured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist.

Melbourne Water noted in Section 1 that these criteria would be applied on a case by case basis to determine declaration of a particular infrastructure service. Further, that these criteria could be applied more broadly to define the eligible services that might be subject to declaration or an access undertaking.

### Infrastructure types

There are six key types of water supply and sewerage infrastructure controlled by Melbourne Water, namely:

- Water harvesting and seasonal storages
- Other water storages
- Water treatment facilities
- Water transfer pipelines
- Sewerage treatment facilities
- Sewerage transfer pipelines.

Melbourne Water's infrastructure connects to water distribution and sewerage collection infrastructure owned by the metropolitan retailers, as well as Western Water and Gippsland Water.<sup>7</sup> The integrated operation of this infrastructure supports service provision to all connected households and businesses.

## Water

Melbourne Water has four key types of water infrastructure assets — water harvesting and seasonal water storages, other water storages, water treatment facilities and water transfer services.

### Water harvesting and seasonal storages

The ESC's Issues Paper notes the services covered by an access regime are likely to include storage facilities for water, such as local storages, that are integral to the water transfer infrastructure. It also raises the possibility of the water storage services of large dams being covered by an access regime.

The primary role of the harvesting storages operated by Melbourne Water is to 'produce' water. Although water harvesting storages may be uneconomic to duplicate, the service they provide (i.e. water 'production') is potentially competitive. This is illustrated by the fact that in the future, Melbourne's water production will be provided by a number of other facilities (e.g. a desalination plant).

Seasonal water storages may also be uneconomic to duplicate. However, they are difficult to separate from the harvesting function because they play a role in enabling the maximisation of system yield (i.e. in maximising water 'production').

Melbourne Water believes that access to water harvesting and seasonal storage infrastructure is unnecessary as access will not enhance competition in any upstream or downstream market. These services are in fact a part of the upstream market.

---

<sup>7</sup> In the future it will also connect to other water businesses surrounding Melbourne, including Barwon Water, Westernport Water and South Gippsland Water.



Further, entitlements to the inflow and storage capacity of Melbourne's headworks system (both at the harvesting and seasonal storage level) have already been defined and allocated. These have been defined by establishing bulk entitlements to the water resource and shares in storage capacity, including for seasonal storages. The need for third party access under these entitlements, may, therefore be limited.

These bulk entitlements are primarily held by the three metropolitan retailers (as a pool), although in the case of the Thomson reservoir a small amount of storage capacity has been allocated for Southern Rural Water's irrigation requirements and the environmental flow requirements of the Thomson River.

The bulk entitlements, together with system operating rules (see below), define the constraints within which entitlements can be used and the degree of flexibility an entitlement owner has in relation to the use of its entitlements. Management of the pooled entitlement is overseen by the Bulk Entitlement Management Committee, which comprises the three metropolitan retailers, Melbourne Water, DSE and other existing and future entitlement holders to the Melbourne water supply system.

These bulk entitlement orders require that Melbourne Water operates its water supply system in accordance with a transparent set of Storage Management Rules. The purpose of these rules is to ensure that both the interests of consumptive and environmental entitlement holders are met, and the efficient, safe and reliable operation of the Melbourne water supply system continues. Melbourne Water develops and annually reviews the Storage Management Rules in consultation with the Bulk Entitlement Management Committee.

Melbourne Water also develops an Annual Operating Plan each year, consistent with the Storage Management Rules, which outlines the most likely operating scenario for Melbourne water supply system in accordance with demands of the metropolitan retailers for the coming year. This plan is subject to the endorsement of the Bulk Entitlement Management Committee. Melbourne Water is also responsible for making decisions on releases from different storages within the guidelines set out in its Annual Operating Plan.

The issuing of entitlements, together with the Storage Management Rules and the Annual Operating Plan, provides the regulatory framework under which water businesses hold and make use of the water resources and storage capacity. This framework may evolve to facilitate the development of wholesale competition (i.e. to make the entitlements more tradeable).<sup>8</sup> In these circumstances, it is not obvious

---

<sup>8</sup> The issue of wholesale competition in Victoria's water sector was considered in the recent Victorian Competition and Efficiency Commission's (VCEC) inquiry 'Water Ways: Inquiry into the reform of the Metropolitan Retail Water Sector'. The two options considered in relation to wholesale competition in this

there is a need to provide access to the storages to promote competition. Indeed, providing access would seem to be contrary to the intent of introducing wholesale competition and may limit the flexibility the regulatory framework and entitlement regime is designed to create.

Although there is currently capacity within the harvesting and seasonal storage system, this will be impacted by ongoing seasonal variability and the completion of the augmentation projects. The presence of capacity does not in itself warrant access to storage facilities (as under an entitlement framework that capacity could be traded to ensure its highest valued use). The use of existing harvesting and seasonal storage system for storing water sourced from the forthcoming desalination plant and the North South pipeline is a matter for the holders of the entitlements, and will need to be managed in accordance with the rules outlined above.

### Other water storages

Water storages that are not involved in the water harvesting and seasonal storage function (known as service reservoirs) are typically considered to be an integrated part of the transfer system. As can be seen in Appendix 1, these service reservoirs exist, in various sizes, throughout Melbourne Water's water transfer system. The service reservoirs are used to optimise system operation and investment.

Melbourne Water considers that service storages are best viewed primarily as part of the water transfer system. Granting access to transfer services (see below) implies that service storages may also be subject to an access regime.

### Water treatment

The naturally high level of water quality within Melbourne's supply system helps to minimise the need for the use of treatment facilities. There are, however, several parts of the system where water treatment facilities are used. Notably the Winneke Water Treatment Plant for water which is sourced from the Yarra River and the Yan Yean Water Treatment Plant for water sourced from Wallaby and Silver Creeks. These treatment plants are effectively part of the water 'production' function, as they are used to facilitate the optimisation of water production.

---

report were competitive sourcing and the development of an urban water market. The VCEC's discussion of these options highlighted the need for the existing entitlements to be reformed, measures around environmental and health requirements to be put in place and potential institutional reform (including the creation of a new system operator role) to occur before wholesale competition could be achieved in Victoria's metropolitan area.

There are also treatment facilities at the seasonal storages and within the transfer system to maintain water quality from source to the interface point between Melbourne Water's assets and those of the metropolitan retailers.

The ESC's Issues Paper notes that water treatment is potentially a competitive service. Melbourne Water agrees with this position and believes that access to water treatment infrastructure is unnecessary as these facilities are likely to be economical to duplicate.

The only exception to this may be the smaller treatment facilities, e.g. chlorination facilities, which are an integrated part of the transfer network. Granting access to transfer services (see below) implies that access to treatment facilities of this nature is also likely.

It is noted that water treatment facilities are excluded from the access regime which applies in NSW because these facilities are considered to be part of the water production process. The NCC has not raised any concerns in this respect in its draft recommendation on certification of the NSW regime.

## Water transfer

Melbourne Water recognises that the water transfer system is generally not economic to duplicate and that access to these assets may be necessary to enhance competition in downstream and/or upstream markets. For these reasons, Melbourne Water supports the inclusion of water transfer infrastructure within the definition of an eligible service in any third party access regime (with the result that it is potentially subject to a coverage declaration or an access undertaking). Access would be subject to declaration and ensuring that any legislative, regulatory or contractual requirements that Melbourne Water must meet, including those around public health, can be satisfied, and that appropriate access prices apply.

Any future access arrangement for water transfer infrastructure would also need to be designed in a way that is cognisant of Melbourne Water's operational considerations.

## Sewerage

Melbourne Water has two types of sewerage infrastructure assets — sewerage treatment facilities and sewerage transfer pipelines.

### Sewerage treatment

As noted in the Issues Paper, the treatment of sewage is potentially a competitive service. Melbourne Water agrees with this position, and also considers that sewerage

treatment infrastructure is economic to duplicate, and for this reason access to the Melbourne Water's Eastern and Western Treatment Plants is unnecessary.

It is noted that sewerage treatment facilities are excluded from the access regime which applies in NSW because these facilities are considered economically feasible to duplicate. The NCC has not raised any concerns in this respect in its draft recommendation on certification of the NSW regime.

### Sewerage transfer

Melbourne Water recognises that the sewerage transfer system is generally not economic to duplicate and that access to these assets may be necessary to enhance competition in upstream and/or downstream markets. For these reasons Melbourne Water would support the inclusion of sewerage transfer infrastructure within the definition of eligible services in any third party access regime (with the result that it is potentially subject to a coverage declaration or an access undertaking). Access would be subject to declaration and ensuring that any legislative, regulatory or contractual requirements that Melbourne Water must meet, including those around public health, can be satisfied, and that appropriate access prices apply.

Any future access arrangement for sewerage transfer infrastructure would also need to be designed in a way that is cognisant of Melbourne Water's operational considerations.

Melbourne Water notes that in Sydney, the Bondi, Malabar and North Head sewerage networks have been treated as discrete systems, with access provided to each system as a 'whole' rather than separate parts alone.

# 3 Access pricing

## Overview

The issue of access pricing is a central consideration for any access regime. Melbourne Water recognises the importance of establishing pricing arrangements which are transparent and which provide guidance and a degree of certainty to industry participants and access seekers about the broad terms that will accompany any request for access, and the scope that exists to negotiate. Melbourne Water is also of the view that the pricing arrangements associated with a future access regime should be flexible to cater for varying access requests and changes in the nature of the system and its operation.

## Pricing principles for third party access

The ESC's Issues Paper outlines a number of principles as set out in the Competition Principles Agreement (and the *Essential Services Commission Act 2001*) that access pricing methodologies must satisfy. These principles indicate that access prices should be set so that:

- A sufficient amount of revenue to meet the efficient costs of providing the regulated services, including a return on investment that reflects the commercial and regulatory risk involved, is generated
- Multi-part pricing and price discrimination can occur where this will facilitate efficiency
- Vertically integrated infrastructure service providers are not able to set terms and conditions that discriminate in favour of its own downstream operations, except to the extent that the cost of providing access to other operators is higher
- Incentives to reduce costs or otherwise improve productivity are provided.

Melbourne Water acknowledges the appropriateness of these principles. It is noted, however, that in practice the realisation of efficient and transparent pricing outcomes needs to be mindful of the nature and complexity of operational considerations that characterise the water sector.

## Regulatory guidance on prices

The Issues Paper seeks comment on whether or not an access regime should include regulatory guidance on prices, such as indicative tariffs or reasonable price boundaries, to provide a framework for access negotiations between infrastructure operators and access seekers.

Melbourne Water understands the intent of providing further guidance on prices, but considers that the extent of guidance needs to reflect uncertainties about:

- The nature of any future access requirements
- The regularity with which access might be sought
- What is necessary to enable access seekers to negotiate on a reasonable basis with the owner of the infrastructure.

As there is currently uncertainty about the nature of any future access requests for water and/or sewerage infrastructure in the metropolitan area, and the frequency of any such requests, Melbourne Water considers that there is a limit to the level of detail which can be provided in any regulatory guidance material on access prices.

As outlined in Section 2, Melbourne Water is of the view that only its water and sewerage transfer infrastructure is likely to meet the criteria for eligible services under any access regime. In relation to these infrastructure services, Melbourne Water's regulated transfer prices (on a fixed and variable basis) are already set by the ESC on a cost of service approach and are in the public domain (see Table 1 for the variable prices proposed in Melbourne Water's 2009 Water Plan). It is considered, that given the above uncertainties, initially these regulated prices would provide adequate guidance for access seekers.

Table 1 – Melbourne Water's proposed water and sewerage transfer prices

Bulk water transfer services (\$ per ML)	
City West Water	133
South East Water	113
Yarra Valley Water	90
Bulk sewerage service – volume (\$ per ML)	
Eastern system	284
Western system	177

## Access pricing methodologies

The ESC's Issues Paper indicates that there are two main approaches for determining access prices — the cost of service approach and the retail minus approach. In relation to the retail minus approach, the Issues Paper notes that it has generally been used in cases where the final retail price is regulated, where the service is bundled and where the access provider also provides downstream or upstream services associated with the infrastructure in question.

The Issues Paper also notes that Melbourne Water currently recovers the costs of providing water storage and transfer services through regulated bulk water prices paid by the metropolitan retailers and that these could provide a basis for calculating access prices for businesses seeking access to water infrastructure services. Further, that bulk sewerage charges have not been unbundled and currently reflect the costs of both transport and treatment of sewage.

As a general comment, Melbourne Water notes that theoretically the cost of service approach and the retail minus approach should result in the same, or similar, access prices. However, while each should produce equivalent outcomes in relation to accessing a given piece of infrastructure, aggregations in operational cost data could in practice constrain this from occurring. With reference to the access pricing principles outlined above, this observation implies that a degree of compromise may be required when setting prices in an access framework.

Melbourne Water considers that broad pricing principles, consistent with those detailed above and used in the NSW access regime, should be included in any access regime to guide access price negotiations. Application of those principles should take into account:

- The integrated way in which Melbourne Water's water and sewerage transfer infrastructure (which in Melbourne Water's view are likely to services eligible for declaration under an access regime) are operated. For example, although access may be sought to particular elements of Melbourne Water's transfer infrastructure, operational and capacity issues may mean that to take water from point A to point B those particular elements are not necessarily used. This could occur for a variety of reasons. For example, drought, seasonal variation within a year or management of maintenance requirements. These factors could mean that the system is operated in a different manner and that water is transferred through the system from point A to point B using different transfer infrastructure.
- The need to avoid cherry picking by access seekers.

# 4 Water quality and other non-price terms and conditions

## Overview

Third party access will raise important operational issues for water businesses, including how water quality, environmental, and health and safety requirements are met by the access provider and access seeker. While these issues are not insurmountable, if an access regime is introduced they will require detailed consideration. In a third party access regime it will be important that access providers have the ability to manage the risks they will ultimately bear. In this regard, clear and well defined processes will need to be established to ensure appropriate non-price terms and conditions for access are put in place. This will enable third party access to occur, where feasible, but with no reduction in the quality of water and sewerage services provided.

## Water

### Water quality

A key issue associated with third party access is ensuring that there is no reduction in the quality of water supplied to end customers, i.e. there is no increase in water quality risk to the community. Where third party access relates to movement of existing water within the system, potentially facilitated via water trading, water quality is less of an issue. However, where third parties inject water into Melbourne Water's system, e.g. desalinated water, recycled water or treated stormwater, the water quality risks that will need to be managed are much higher. This includes water injected directly into the service reservoirs or the transfer system, particularly as the system cannot be 'turned off' immediately in the event of a problem.

Melbourne Water and the other water businesses are obliged to appropriately manage risks to the quality of water they supply to consumers (under the *Safe Drinking Water Act 2003*). In order to fulfil the risk management obligations, Melbourne Water will be required to demonstrate that individual third party access arrangements do not pose an unacceptable risk to the water supplied by the metropolitan water businesses to consumers.

Melbourne Water considers that in order to adequately manage the water quality risks associated with third party access, there should be early engagement between an access seeker and access provider (as early as at the concept design stage). This



would be facilitated via a clear and well defined process that can be applied on a case by case basis for establishing the terms and conditions of access, including those associated with water quality. It would also identify situations where it is not feasible to grant access to particular infrastructure or to a particular access seeker.

An access regime should detail such a process, and establish the nature of the information requirements necessary for establishing the terms and conditions of access. While it may be considered that such a process extends beyond light handed regulation, given the potential consequences associated with a water quality issue arising, it is seen to be justified.

Key features of the process from the water quality perspective should include:

- The access provider would be required to provide the access seeker with the necessary information to enable the access seeker to assess the viability of its proposed project.
- The access seeker would be required to provide the access provider with specific information in relation to its access proposal, including details about:
  - Where the access seeker proposes to inject the water into Melbourne Water's system (particularly important for the multiple barrier approach to risk management)
  - The risk management system
  - The risk management plan
  - The stakeholder engagement plan
  - The chemical dosing procedures
  - The emergency management procedures
  - The approach to co-operative planning to address future changes to water quality requirements and advancements in scientific or technological information
  - The process for monitoring and auditing implementation of the above.
- The access provider would be required to assess the proposal, taking into account the water quality requirements under the *Safe Drinking Water Act 2003* and decisions guidelines which would set out the issues that water businesses would take into account.
- The access provider would have the ability to seek further information from the access seeker to assist in its assessment.
- The access provider would be required to provide a written decision approving or rejecting the access seeker's proposal. Where a proposal is approved, the decision would need to set out the specific terms and conditions under which it is approved. Where a proposal is rejected, specific reasoning would need to be provided.

- Sufficient timeframes for assessing requests and making decisions would need to be set reflecting the potential complexity of some assessments (e.g. for new sources such as recycled water and treated stormwater).

Melbourne Water's notes its experience with assessing and establishing the requirements for desalinated water to be injected into its, and the retailer's, networks. In total, approximately two years will be required to assess the water source, evaluate the water quality issues and establish appropriate treatment options.

The above process may involve more than one water business where third party access is sought across networks. For example, if access is sought to Melbourne Water's and the retailer's networks.

In the event the access seeker does not agree with the specific water quality terms and conditions determined by the access provider, an access dispute may arise requiring arbitration. Melbourne Water considers that the ESC is generally well placed to arbitrate access disputes. That said, the Water Regulatory Unit of the Department of Human Services, as well as independent technical experts, would likely have a role to play in assisting the ESC on issues relating to water quality and network management.

## Other water issues

In addition to water quality, further issues that will also need to be addressed in establishing the terms and conditions for access, and could be included in the above process, include:

- Hydraulic and network management issues which may occur as a result of changes to flow/pressure due to third party access. This could affect the reliability of supply, Melbourne Water's ability to meet water pressure requirements, and the level of safety in transferring water to existing customers
- Emergency management procedures, which will also be required to deal with unforeseen circumstances, including natural disasters such as bushfires and floods, and the flow on impacts for customers and the environment. These would likely be an extension of current arrangements.

Uncertainty will be a key issue for water businesses to address over the foreseeable future, particularly in relation to climate change and managing the water demand / supply balance. In such an environment, over the longer term, flexibility will be required to enable water businesses to adapt to changing information and circumstances. For example, further empirical evidence in relation to catchment

inflows over the next 5 – 10 years may result in changes to the way Melbourne Water operates its seasonal storage and transfer infrastructure. This could change any excess capacity of the transfer infrastructure. A third party access regime should not limit Melbourne Water's flexibility to implement changed operational arrangements and the requirements of an access regime should be subject to periodic review and access arrangements determined for specified periods of time.

Management of the water demand / supply balance over the shorter term on a daily, weekly and monthly basis is also quite dynamic. In order to ensure system optimisation over the shorter term, it will be important to clearly establish, for any services that are declared under an access regime, the excess capacity of infrastructure services available to access seekers. This should be done in such a way as to ensure that short term system optimisation can continue to occur.

Third party access could also lead to increased costs associated with management of the system. These costs would need to be recognised and recovered. Additionally, compensation might be appropriate where non-price terms and conditions are breached.

## Sewerage

Similar to water, a key issue associated with third party access for sewerage infrastructure is ensuring that there is no reduction in the quality of services provided. For example, that there are no additional sewage spills or that there is no worsening of sewage discharges to the receiving environment. Furthermore, any access regime should not undermine the industry's incentives to continue to innovate to improve environmental standards. The potential risks associated with third party access for sewerage services are particularly related to environmental, health and safety and resource use outcomes.

In some instances, third party access may make it difficult for Melbourne Water to continue to meet its sewage related obligations (environmental, health and safety, contractual, etc). Under an access regime, it will be important that Melbourne Water has the ability to manage the risks associated with third parties potentially diverting inflows from, or increasing flows to, the treatment plants. For example, reduced flows in the sewerage transfer infrastructure and to the treatment plants could:

- Increase the sewage concentration in the sewers and lead to health and safety risks when maintenance is being undertaken

- Increase the sewage concentration and impact on treatment plant performance, heightening the risk that legislative, regulatory and contractual requirements are not met and increasing the cost of treatment
- Increase the sewage concentration, consequentially altering the properties of the biosolids and potentially increasing the risk that reuse targets are not met
- Make it difficult to meet the RAMSAR wetland requirements at the Western Treatment Plant
- Impact on the achievement of recycling objectives and meeting recycled water contractual commitments.

Increased flows in parts of the transfer infrastructure could also lead to greater blockages, bursts, leaks, corrosion and these could result in additional maintenance.

Odour emissions from the transfer infrastructure could also be affected as a result of third party access which increases concentration or reduces flow.

Hydraulic and network management issues could also occur as a result of changes to flow/pressure due to third party access. This could affect the level of safety in transferring sewage to the treatment plants.

Third party access could also lead to increased costs associated with management of the system. These costs would need to be recognised and recovered. Additionally, compensation might be appropriate where non-price terms and conditions are breached.

Melbourne Water also notes the potential difficulty associated with tracking sewage and sewage quality through the sewerage transfer infrastructure. If a third party acquires a sewage catchment of customers and wishes to transfer that sewage through the transfer network to their treatment plant it could prove difficult to determine the attribution of pollutant load from the different customer bases to the different treatment plants. This is particularly because pollution load is not necessarily additive or conserved. Melbourne Water currently manages this issue with the attribution of plant load between the metropolitan retailers, but additional extraction could make this much more complex.

Melbourne Water considers that, as for water, in order to adequately manage these risks a clear and well defined process, that can be applied and adapted on a case by case basis, is required for establishing the terms and conditions of access to declared sewerage services. Such a process would enable the most appropriate terms and conditions to be established for each particular access request, which could differ

significantly in terms of their operational details. It would also identify situations where it is not feasible to grant access to a particular infrastructure or access seeker.

As for water, an access regime should detail such a process:

- The access provider would be required to provide the access seeker with the necessary information to enable the access seeker to assess the viability of its proposed project.
- The access seeker would be required to provide the access provider with specific information in relation to its access proposal, including
  - Where the access seeker proposes to inject or extract sewage and the quality and nature of that sewage
  - Quality management principles around sewage injected into the network
  - Compliance with trade waste parameter requirements.
- The access provider would be required to assess the proposal, taking into account the relevant legislative and regulatory requirements and decision guidelines which would set out the issues that water businesses would take into account.
- The access provider would have the ability to seek further information from the access seeker to assist in its assessment.
- The access provider would be required to provide a written decision approving or rejecting the access seeker's proposal. Where a proposal is approved, the decision would need to set out the specific terms and conditions under which it is approved. Where a proposal is rejected, specific reasoning would need to be provided.
- Sufficient timeframes would be required for assessing requests and making decisions, reflecting the potential complexity of some assessments.

While it may be considered, as for water, that such a process extends beyond light handed regulation, given the complexity and potential consequences outlined above in relation to meeting Melbourne Water's sewage related obligations, it is seen to be justified.

As for water, following this process an access dispute may arise requiring arbitration. Melbourne Water considers that the ESC is generally well placed to arbitrate access disputes. That said, the Environment Protection Authority and independent technical experts would likely have a role to play in assisting the ESC on issues relating to sewage flows / quality and network management.

## Existing regulatory requirements

In its Issues Paper the ESC notes the importance of protecting public health and water as well as environmental protection.

Melbourne Water and other water businesses are subject to an extensive number of legislative and regulatory requirements designed to protect public health, including that of its employees, and the environment. For example, Melbourne Water must meet water quality, sewage spills and sewage treatment and disposal requirements. In developing a state based access regime, a full and comprehensive review will be required of all legislative and regulatory requirements. This will be required to determine whether any changes are necessary to allow for third party entry and no reduction in the quality of services provided, while ensuring a level playing field for access providers and access seekers.

# 5 Other legislative, regulatory and co-ordination issues

## Overview

Melbourne Water considers that a licensing framework, in conjunction with the process outlined in Section 4 for establishing non-price terms and conditions, will assist in managing the potential risks associated with entry by third parties. Licensing applications should be reviewed by the Minister for Water, following recommendations from the ESC, DSE and other relevant stakeholders. In addition, any information and reporting framework should be designed to ensure the benefits outweigh the costs and take into account information requirements under the existing regulatory framework.

## Licensing framework

In its Issues Paper, the ESC notes that an access regime for water and sewerage infrastructure will need to include appropriate mechanisms to ensure that access seekers comply with all relevant customer protection, health and safety, and environmental protection requirements. Licensing is one way in which this could be achieved.

If a state based access regime is introduced, Melbourne Water believes that parallel licensing requirements would be required. A licensing framework would ensure that protections are in place in relation to:

- The services supplied by the new infrastructure (water or sewerage) owned and operated by the third party
- The retail services provided by the third party.

Any licensing arrangements would need to accord with existing standards, as currently applied to the water businesses, including those under the *Safe Drinking Water Act 2003*, the *Environment Protection Act 1970* and restriction levels. This would ensure that minimum and consistent protections are in place.

Melbourne Water considers that in conjunction with the process detailed in Section 4 for establishing non-price terms and conditions of access, a licensing framework will ensure the potential risks associated with third party access can be managed. Water businesses would be able to manage the risks associated with access to their

infrastructure and the third parties would be required to manage the risks associated with supply via their new infrastructure and / or retail supply.

Melbourne Water supports the approach adopted in NSW which involves the Minister making licensing decisions based on recommendations by IPART. As the ESC notes, in Victoria the Minister for Water is responsible for water and environmental policy issues and imposes obligations on water businesses in relation to these issues. As a result, the Minister is best placed to make licensing decisions. The ESC and DSE would be well placed to play the role of IPART in making recommendations to the Minister. It may also be appropriate for the Environment Protection Authority and the Department of Human Services to have the ability to submit an assessment of potential licence holders given their expertise.

## Information requirements

A third party access regime will create information and reporting requirements for both the access provider and the access seeker. Melbourne Water considers that, consistent with the principle of light handed regulation, any information and reporting framework should be designed to ensure the benefits outweigh the costs and take into account information already available under the existing regulatory framework.

As noted by the ESC in its Issues Paper, it is likely that access seekers will require particular information on industry conditions, costs, the expected demand and supply balance, excess capacity, and other matters to enable them to assess the viability of proposed projects. Water businesses in Victoria are regulated and much of this information is currently available in one form or another. For example, through the ESC's annual performance reports, water businesses' Water Plans and the ESC's price determinations, policy documents such as the *Central Region Sustainable Water Strategy* and *Our Water Our Future, the Next Stage of the Government's Water Plan*, and contractual agreements between water businesses and their customers. Further detail would need to be provided on a case by case basis by the water businesses.

As detailed in Section 4, Melbourne Water is also proposing a process be included in a state based access regime that requires specific information to be provided to enable the assessment of third party access requests. For example, information around water/sewage quality and flow/pressure requirements.

Further, Melbourne Water considers that it should be entitled to maintain commercial confidentiality in relation to its information where appropriate and should not lose the ability to negotiate commercially viable terms and conditions with access seekers.



## 6 Access and future water industry reforms

The ESC's Issues Paper notes that the key purpose of establishing an access regime in the Victorian water industry is to enhance competition in upstream and downstream markets. That said, it notes that a number of complementary reforms will be necessary to facilitate competition and obtain the full benefits from opening up the provision of water and sewerage services to new providers. Further, that it is clear from experiences in other industries that implementing a strategy to enable greater competition in an industry dependent on natural monopoly facilities is a lengthy and evolving process.

Third party access is one mechanism for facilitating increased upstream and downstream competition. Melbourne Water considers that in addition to focusing on how to deliver competition, it will also be important to examine the key issues of what might be the nature, extent, costs and benefits of competition in these markets. Ideally, considerations around third party access should be moving forward at the same time as considerations around the scope for competition in the wholesale and retail markets. This would enable the access regime to meet the needs of the competition that is likely to emerge (i.e. it is fit for purpose).

At this stage, there has been limited demand for third party access in metropolitan Melbourne and examples of negotiated access. This is consistent with empirical evidence in the water industry in other jurisdictions, including NSW and England and Wales. Consequently, a light handed and staged approach to access regulation is appropriate to minimise the regulatory impost, while still fostering opportunities for competition. This should also provide sufficient flexibility for the regime to evolve as additional reforms are implemented

# Appendix 1

