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Mr Dennis Cavagna
Acting Chairperson
Essential Services Commission
Level 2, 35 Spring Street
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Dear Mr Cavagna

**STATE-BASED ACCESS REGIME FOR WATER AND SEWERAGE
INFRASTRUCTURE SERVICES IN VICTORIA**

In accordance with my powers under section 41 of the *Essential Services Commission Act 2001*, I refer to the Essential Services Commission the attached Terms of Reference for an inquiry into the development of a state-based access regime for water and sewerage infrastructure services, including the access pricing methodology for the Victorian water industry.

Should you require any further information please contact Mr Daen Dorazio, Senior Economist, at the Department of Treasury and Finance on 9651 1650.

Yours sincerely

TIM HOLDING MP
Minister for Finance, WorkCover
and the Transport Accident Commission

Essential Services Commission Act 2001

Part 5 Inquiry and Report

Notice of Reference – State-based access regime

Pursuant to section 41 of the Essential Services Commission Act 2001, I, Tim Holding MP, Minister for Finance, WorkCover and the Transport Accident Commission, hereby direct the Essential Services Commission ('the Commission') to conduct an inquiry into development of a state-based access regime for water and sewerage infrastructure services, including the access pricing methodology for the Victorian water industry.

Background

Victorian Competition and Efficiency Commission (VCEC) Inquiry into Reform of the Metropolitan Retail Water sector

On 21 August 2007 the Victorian Government directed the VCEC to undertake a review of the metropolitan retail water sector. On 3 July 2008, the Government released the final VCEC report on the Inquiry into Reform of the Metropolitan Retail Water Sector and the Government's response to this report.

The Victorian Government, in its response to the VCEC report, supported the recommendations that:

- the Government develop an access regime for water and sewerage infrastructure services (recommendation 5.6);
- the access regime that is established give responsibility to the Essential Services Commission to develop the access pricing methodology, having regard to the legislative objectives of a state-based access regime (recommendation 5.7); and
- the Commission should develop a methodology for implementing accounting ring-fencing, audit the information provided and publish the information as part of its ongoing monitoring role for the Victorian water sector (recommendation 4.2).

A state-based access regime will facilitate the efficient use of Victoria's water infrastructure by improving regulatory certainty for all parties regarding the framework for third parties seeking involvement in the water sector.

As a first step, the Government committed to ask the Commission to undertake an inquiry into the development of a state-based access regime, following consideration of the broader objectives of an access regime.

Consultation on and findings of the inquiry should provide the Government with the necessary information to implement an access regime as soon as practicable.

The Government will consider the final report once it is received from the Commission and proceed with drafting a state-based access regime as appropriate.

Scope

The focus of the inquiry will be to assess and make recommendations on the development of a state-based access regime for water and sewerage infrastructure services in Victoria. This will include issues related to introducing ring fencing (including an accounting methodology). The regime is intended to cover water and sewerage infrastructure across the state of Victoria.

The Government's objectives in supporting the establishment of a state-based access regime include to:

- promote the economically efficient operation of, use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets;
- not put at risk the ability of third parties or existing water businesses to comply with relevant objectives in other legislation and regulatory instruments including those related to resource management, the environment, water quality, health and safety;
- provide consistency (where appropriate) and certainty for market participants and potential new participants about the terms and conditions under which access can be sought to Victoria's water and sewerage infrastructure services;
- facilitate the development of innovative local solutions to water supply, consistent with broader sustainable urban planning objectives; and
- not inhibit the potential for further reform of the water industry in the longer term.

Consistent with the Competition and Infrastructure Reform Agreement, the Victorian Government intends to seek certification from the National Competition Commission of any state-based access regime.

Recommendations should be cognisant of other work programs that are taking place in Victoria's water sector including:

- arrangements for optimising system management of the expanded water grid and new water sources, so that the desired level of security is achieved by relying on the least cost sources of supply first;
- amendments to bulk water entitlements, to reflect the new water sources (i.e. the desalination plant and Sugarloaf pipeline);
- consideration of whether market-based mechanisms could be used to inform future management decisions;
- appropriate roles and responsibilities in the new system; for example, whether an independent system or grid manager should be established;
- expansion and increased interconnectivity of the Victorian Water Grid;
- the report to Government that is being developed by the Department of Sustainability and Environment to clarify rights to alternative water sources and identify where the rights framework could be improved (VCEC recommendations 5.2 and 5.3); and
- objectives and key principles of water sensitive urban design.

The Commission should have regard to the *Constitution Act 1975*, which outlines the Victorian Government commitment to public ownership of water businesses.

In conducting the inquiry, the Commission may have regard to access regimes in other industries and state-based access regimes that have been developed or are being developed in Australia. However ultimately the Commission should ensure its recommendations are specific to Victoria's water and sewerage infrastructure services and the Government's objectives in developing an access regime.

The Government will have regard to the recommendations from this inquiry when developing a state-based access regime for water and sewerage infrastructure services.

Recommendations may include timing for a review of the access regime in the future to ensure it remains relevant and effective.

In the course of the review the Commission may make recommendations regarding:

- how to best give effect to the access regime having regard to other VCEC recommendations, including that the retailers will be made statutory corporations under the *Water Act 1989*;
- the expected time taken to establish and have the access regime certified;
- any transitional measures that may be appropriate; and
- any technical requirements, guidelines or regulations required to give effect to the regime.

The Commission may also make observations regarding potential barriers to effectively implementing the access regime.

Specific Terms of Reference

The Commission will ensure its recommendations are consistent with National Competition Policy, including the Competition and Infrastructure Reform Agreement and competitive neutrality principles and policies.

Recommendations should be consistent with the principles in clause 6 of the Competition Principles Agreement. The National Competition Council has given guidance on how it considers these principles under the following categories:

- coverage of services – appropriately identifying and defining the services of the water and sewerage supply chain to which access is to be provided, noting that for certification, the services must be provided by infrastructure that is not economical to duplicate and acts as a bottleneck to competition in other markets;
- negotiation framework – establishing a legal right for parties to negotiate access, an enforcement process to support this right, requiring service providers use all reasonable endeavours to accommodate the requirements of access seekers, requiring that access outcomes strike an appropriate balance among a range of factors including the legitimate business interests of facility

owners, the efficient use of infrastructure and competitive outcomes that benefit the community, and having a regulatory framework that includes appropriate ring-fencing within a regulated business and prohibits conduct for the purposes of hindering access;

- dispute resolution – provide mechanisms to resolve a dispute between a service provider and access seekers;
- appropriate terms and conditions of access – terms and conditions should promote the efficient use of infrastructure and efficient investment in dependent markets while not deterring efficient investment in infrastructure. The access regime will need to be guided by the pricing principles set out in s35C of the *Essential Services Commission Act 2001*. Access terms and conditions should address safety requirements, the allocation of capacity among competing users, interoperability issues, and service quality issues;
- transitional arrangements – may include timetables to phase in availability for different classes of customer, and potential interim arrangements. Arrangements should be necessary and phased out as early as possible;
- greenfields investment – the access regime should not inappropriately deter new investment in infrastructure; and
- interstate issues – ensure state-based access solutions do not pose an impediment to interstate access if relevant.

The Commission should also consider and make recommendations on:

- whether different services will require different access arrangements;
- who will be eligible to seek access;
- the role of the Essential Services Commission as regulator;
- information requirements access providers will be required to publish;
- other information and reporting requirements;
- the responsibilities of network operation and maintenance;
- responsibilities for approving, undertaking and financing expansion of the network;
- specification of and obligations with respect to service quality, environmental and public health standards; and
- responsibility for network balancing and associated costs.

The Commission will also make recommendations on the methodology for access pricing and appropriate ring fencing (including an accounting methodology addressing recommendation 4.2 from the VCEC report).

Factors to consider in evaluating the different approaches to access pricing, cost allocation and ring fencing will include:

- new entry and administrative burdens; and

- the need for any amendments to existing arrangements, such as Regulated Asset Values, to meet the Government's objectives for establishment of an access regime.

The Commission will also ensure its recommendations are consistent with the relevant sections of the *Essential Services Commission Act 2001*, including the objective of the Commission in section 8 and Part 3A relating to third party access regimes.

Review Process

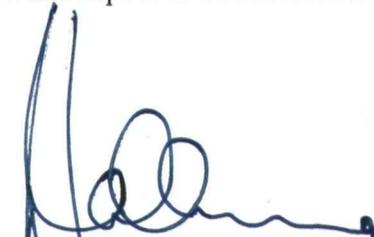
The Review will be conducted independently by the Victorian Essential Services Commission (ESC) under s.41(1) of the *Essential Services Commission Act 2001*, which requires that: "The Commission must conduct an inquiry into any matter which the Minister by written notice refers to the Commission under this Part".

In conducting the inquiry, the Commission will make publicly available a draft report and seek submissions regarding this inquiry. The final report will be submitted to the Minister and made publicly available consistent with s. 45 of the *Essential Services Commission Act 2001*.

The specific design and conduct of the review process will be determined by the Commission and publicised at the outset of the review.

Timetable

Review to commence	November 2008
Draft report to be submitted	May 2009
Final report to be submitted	31 August 2009



TIM HOLDING MP
Minister for Finance, WorkCover
and the Transport Accident Commission.

Date: 19/11/2008