



27 October, 2005

Dr Michael Keating, AC
Chairman
The Independent Pricing and Regulatory Tribunal
PO Box Q290
QVB Post Office NSW 1230

Dear Dr Keating

Water and Wastewater Service Provision in the Greater Sydney Region

ABN AMRO welcomes the opportunity to respond to the Draft Report of IPART's Investigation into Water and Wastewater Service Provision in the Greater Sydney Region ("Draft Report").

ABN AMRO is a leading provider of public infrastructure solutions in Australia. It has also provided extensive corporate advisory and capital markets services to Commonwealth and State Governments in relation to a range of Government owned businesses, as well as to privately-owned regulated businesses.

ABN AMRO supports reform of the Sydney water and wastewater markets.

ABN AMRO agrees that the development of an access regime and the opening of new infrastructure developments to competition are important elements of a reform agenda. Accordingly, ABN AMRO welcomes the Draft Report as an important first step in the reform process. ABN AMRO also believe that the benefits of the initial reforms could be optimised if further consideration is given to the pursuit of more comprehensive structural reforms in parallel with the initial reforms.

ABN AMRO supports the facilitation of private sector involvement in the provision of all new and brownfield water and wastewater infrastructure, where this represents value-for-money compared with comparative conventional Government procurement costs after adjustment for optimism bias and other risks. ABN AMRO also supports the promotion of competition in the development of innovative new water supplies and the provision of infrastructure in Sydney and new growth areas. We believe that it may be prudent to have completed the structural regulatory reforms in advance of this involvement.

ABN AMRO's comments on selected elements of the Draft Report follow.

1. Development of an access regime

ABN AMRO welcomes the Draft Report's recommendation that an access regime be developed to allow the private sector to engage directly with customers in the supply of water and wastewater services. ABN AMRO believes that greater competition and market access could deliver substantial benefits to government, customers and the environment, by:

- increasing the utilisation of the existing asset base;
- developing new water supply and treatment solutions;
- encouraging innovation in supply and delivery;
- improving efficiency in water use; and
- encouraging sustainable and environmentally friendly outcomes.

We note IPART's preference for an access regime to be developed progressively, commencing with a definition of high level regulatory principles (to guide initial investment decision-making), followed by the development of a detailed regulatory regime.

While we acknowledge the basis for recommending an "adaptive management" approach to developing the proposed third party access regime, in ABN AMRO's experience investors and financiers will require a high degree of certainty of the conditions under which they will be granted access to a monopoly network prior to investing in infrastructure which depends on that network. High level guiding principles are unlikely to be a sufficient basis on which to invest. We consider that uncertainty over the details of the access regime and the associated regulatory environment has the potential to negate the benefits of competition by discouraging new entrants into the market.

Financiers are highly sensitive to regulatory risk and will prefer to see a stable and established regulatory regime prior to committing finance. For this reason, ABN AMRO believes that further attention could be given to the nature of the regulatory arrangements that will apply to the new regime, and the timing of its implementation. Specifically, we believe that an access regime and a supporting regulatory framework will need to be in place before any substantial investment by the private sector is forthcoming. If the Government's priority is to encourage innovative and sustainable private investment, consideration should be given to developing and implementing an access regime as early as is practicable.

There are a number of well-developed and tested access regimes from other sectors (eg. electricity, gas and rail) which might be adapted appropriately and applied to Sydney's water and wastewater infrastructure. While certain modifications may be required to take into account some of the peculiarities of water and wastewater services (eg. differences in wastewater "quality"), the general principles of access should be readily transportable from these sectors into the water and wastewater sector, allowing for the timely development of an access regime.

2. Structural reform of Sydney Water

We note IPART's draft recommendation that vertical disaggregation of Sydney Water not be pursued at this time. ABN AMRO believes that parallel structural reform of Sydney Water would support the success of an access regime. In particular, we consider that some form of structural separation between Sydney Water's monopoly infrastructure and its operations which would become contestable under an access regime, would help to create a competitive market and discourage inappropriate use of market power by Sydney Water. ABN AMRO notes that without separation, the economic and environmental benefits of competition and private investment may not be optimised.

There is precedent in other utility sectors, such as electricity, gas and rail, where the implementation of access regimes has been accompanied by vertical disaggregation of incumbents. The form of vertical disaggregation has ranged from accounting separation and internal reorganisation to the creation of separate legal entities.

ABN AMRO is of the view that, at a minimum, consideration be given to the vertical disaggregation of Sydney Water, by separating the retail business (covering water supply sourcing and wastewater treatment) from the monopoly network business. This cost of this "weaker" form of separation such as accounting separation, is unlikely to be high, and important economic and environmental benefits of

innovation would be more likely to flow as a result. Further, ABN AMRO believes that structural separation would address more effectively the potential for the incumbent to frustrate competition, and be able to be effected at a lower cost than alternative forms of regulatory oversight that might be required in the absence of structural separation.

For these reasons, ABN AMRO would encourage IPART to consider further some form of vertical disaggregation of Sydney Water, to be implemented in parallel with an access regime. We note that further consideration of this seems to have been contemplated by IPART.¹

3. Delivery of the reforms

ABN AMRO supports the proposal to create a high level, central government unit to deliver the proposed reforms. This is based on observations of reforms in other infrastructure sectors where a central unit, separate from incumbent businesses, has been accountable for delivering reforms, and where incumbent businesses have been responsible for complying with the reform framework.

ABN AMRO considers the primary focus of this unit could be on establishing the legal framework for access and ensuring the compatibility of existing laws with the new regime.

The Draft Report suggests that the central unit may also be responsible for reviewing specific private sector investment proposals which may be facilitated by an access regime. It would be important for the central unit to be cognisant of the range of investment options which an access regime may facilitate, to enable it to design arrangements which maximise the scope for innovation and competition. However, it is not clear that the unit would require a separate review and approval role in relation to specific private investment proposals. Charging the unit with this role may risk duplication of other licensing and approval arrangements (eg. development approvals, health regulations, private financing policy administration etc) and may have the potential to delay unnecessarily and/or prevent commercially viable and environmentally beneficial projects.

Instead, an approach similar to that taken in other infrastructure sectors (eg. electricity) might be appropriate. Under this approach, Government's role could be to maintain an appropriate regulatory framework, determine necessary approvals/licences (eg. development approvals) to help minimise externalities, and to enforce compliance with the regulatory framework and approval/licence conditions. If specific projects comply with this regulatory framework, and are commercially viable (as determined by their ability to attract equity and debt capital), there need not be further barriers to their implementation.

Once again, we would like to thank you for the opportunity to comment on IPART's Draft Report, and we are happy to further discuss our comments with IPART.

Yours sincerely,
 ABN AMRO Australia Limited



John Hall
 Managing Director, Head of Structured Capital Markets



Luke Parsons
 Director, Public Sector

¹ Draft Report, page 28.