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TRANSCRIPT OF PROCEEDINGS

PRODUCTIVITY COMMISSION

INQUIRY INTO THE GAS ACCESS REGIME

MR A. HINTON, Presiding Commissioner
DR M. FOLIE, Associate Commissioner

TRANSCRIPT OF PROCEEDINGS

AT PERTH ON MONDAY, 1 SEPTEMBER 2003, AT 9.15 AM

MR HINTON: Welcome to the public hearings for the Productivity Commission's review of the Gas Access Regime. My name is Tony Hinton and I am the presiding commissioner on this inquiry. My fellow associate commissioner is Michael Folie to my left. The inquiry started with a terms of reference from the Commonwealth Treasurer in June this year and covers the following matters: the benefits and costs and effects of the Gas Access Regime including, in particular, its effect on investment; secondly, improvements to the Gas Access Regime, its objectives and its application to ensure uniform third-party arrangements are applied on a consistent national basis; thirdly, how the Gas Access Regime might better facilitate a competitive market for energy services; fourthly, the appropriate consistency between the Gas Code, the National Access Regime and other access regimes; fifthly, the institutional and decision-making arrangements under the Gas Access Regime; and the last point I would refer to is the appropriateness of including in the Gas Code minimum - that's price and non-price - requirements for access to users. I'm sure those terms of reference are familiar to all here today.

The commission has already talked to a range of organisations and individuals and companies with an interest in these issues, and submissions have been coming in to the inquiry following the release of an issues paper in July. The commission is grateful to the various organisations, companies and individuals in Western Australia who have already participated in the inquiry, and we're delighted to be here in Perth this morning. The purpose of these hearings is to provide an opportunity for interested parties to discuss their submissions and their views on the public record. Following these hearings in Perth, hearings will also be held in Adelaide, Melbourne, Brisbane and Sydney. We will then be working towards completing a draft report for public comment by mid-December and will invite participation at another round of public hearings after interested parties have had time to read, absorb and respond to that draft report.

We like to conduct these public hearings in a reasonably informal manner but I remind participants that a full transcript is being taken. For this reason questions from the floor cannot be taken during the course of the proceedings, but at the end of the day I will provide an opportunity for anyone who wishes to make a brief presentation. That of course would be part of the formal hearing proceedings. Participants are not required to take an oath but are required under the Productivity Commission Act to be truthful in their remarks. I should add, though, that participants are welcome to comment on the issues raised in other submissions. They're not constrained to just commenting on their own submission and their own views. They can react to others.

The transcript will be made available to participants and will be available from the commission's web site following the hearings. Copies may also be purchased using an order form available from staff here today. I should also add that submissions to this inquiry are of course available on our web site. A bit of housekeeping: to comply with the requirements of the Commonwealth Occupational Health and Safety legislation, I'm obliged and required to inform all those here today of the fire exits and evacuation procedures that operate in this particular part of this building. The exits are there and there, right behind you or to your right. They work on a beep-beep whoop-whoop system that I'm sure some of you are familiar with, and the assembly point is out in front of the lifts and there will be staff there to show you where the exit points are out of this first floor down to the ground floor, and where the assembly point is later.

That is the conclusion of my opening welcoming remarks. I'd now like to invite the first to appear at this public inquiry - that's Mr Bill Nagle and Mr Garth Crawford from the Australian Gas Association - to come forward to the microphones on my right. Welcome to the inquiry, to today's proceedings. What I'd like you to do at the outset is to, for the sake of the transcript and to assist Susan recording, identify yourself and your organisation. Then, Bill, I invite you to make an introductory statement or a summary statement of your views on this matter.

MR NAGLE: Thank you very much. I'm Bill Nagle, the chief executive of the Australian Gas Association, and with me today is my associate.

MR CRAWFORD: Garth Crawford, the regulatory affairs manager of the Australian Gas Association.

MR NAGLE: I'd like to just make a couple of opening comments and then come back at the end and say a few more things, and in between Garth Crawford will go through some of the more detailed recommendations that we have in our submission. We're certainly pleased to be here for this public hearing and to have an opportunity to present to the inquiry. We were very active in seeking to have the inquiry established, given the five or six years of the existence of the Gas Access Regime and the Gas Access Code. We thought it was a very appropriate time to have a review, particularly in the light of some of the earlier work that had been done by the Productivity Commission on the more generic third-party access regime review that came out last year.

I should say at the outset that the AGA represents the downstream components of the Australian natural gas industry, with membership including gas distribution network companies, gas transmission pipeline companies and gas appliance and equipment companies. Just a couple of words about the nature of the assets that we're talking about. We have spoken to you in the lead-up to this inquiry but it's worthwhile for the public record, I think, just to spell out very briefly some of the assets we're talking about here which are subject to the access regime.

Our gas distribution businesses deliver natural gas to an estimated 3 and a half million households and businesses through low and medium-pressure distribution pipeline networks, mainly under and around urban areas. Gas transmission businesses typically operate long-distance high-pressure pipelines that bring gas from a production basin to major industrial customers located along the pipeline and to the edge of the gas distribution network known as a citygate. We understand that you've recently had a tour of the interface between some of these assets around the Melbourne region, which I think was probably a very useful thing.

Clearly there are some important operational differences between those two types of assets, but essentially the regulatory climate and the issues that surround it, and the debate around the regulatory climate and the regime, are very much the same. Although you have seen the asset types differ, it's important to remember the Gas Access Regime covers both the transmission sector and the distribution sector. The AGA is speaking to you today, however, principally from the point of view of the owners of gas distribution businesses, ie the low to medium-pressure businesses around urban and regional areas, rather than necessarily from the pipeline perspective. The gas distribution businesses are our association's major membership category. Later in the hearings I'm sure you'll hear from representatives of gas transmission pipelines, the high-pressure part of the gas delivery chain, but clearly an effective gas access regime is a key issue for both the networks and the transmission sectors.

The distribution businesses are the largest single type of asset regulated under the Gas Access Regime, both in sunk capital value terms and in the length of network. There is 75,000 kilometres of gas distribution networks under the regime, valued at around about 5 and a half billion dollars. In contrast, the total length of the gas transmission pipelines, although much more public sort of assets in many respects, are 20,000 kilometres and sunk capital value of around about 3 and a half billion dollars. Gas distribution networks are very capital intensive businesses and each year gas distribution businesses undertake capital investment of approximately 250 million dollars in network reinforcement, expansion and extensions - essentially the capex part of the annual expenditure. As well as this, there's a total of around about $300 million annually on operating and maintenance costs, or opex.

You have seen our submission. We circulated to you a very recent draft last week because, given that we're the first people on the review hearings, we thought that given that the document is reasonably weighty, we didn't want to sort of confound anybody. Now, it is a long document but we emphasise that it's broken up into 10 discrete elements in bite-size proportions. We don't propose to summarise the submission here; I'm sure you'll be happy to hear that. The 10 recommendations fall under three thematic headings which broadly follow the structure of the commission's issues paper. These three headings in groups of recommendations relate first of all to improving access pricing, regulatory guidance and accountability, creating incentives for investment in new and existing infrastructure and ensuring the appropriate scope, governance and administration of the regime. So they're the three elements.

The recommendations have been developed in consultation with our core membership, the gas distribution networks. We've also heeded the Productivity Commission's request to provide evidence and examples of deficiencies in the regime and have worked hard to provide these. Our submission contains detail and examples to support AGA's recommendations to the reform of the regime. Also, AGA's individual members are ideally placed to provide additional material that may be commercially sensitive or which relates to the impact of the regime on specific projects. We understand they will provide this to you and we would encourage you to question them in that regard.

The regime has essentially got three broad components. It's got an open access objective, a set of ring fencing provision and access pricing provisions.

Just to deal with an issue right up-front here, our enthusiasm for review of the regime and the code has absolutely nothing to do with seeking to roll back what is, we believe, established good public policy which is open access in the pipeline distribution and transmission networks. There's absolutely no objective in our approach here to go back to pre mid-1990s arrangements where open access was not the norm. Open access, ring fencing and a whole range of other elements of the access code are essentially settled issues and, if you look at the corporate structures, the type of business models that our members are pursuing are a long way advanced from where they were in the mid-1990s. We accept open access and ring fencing of businesses, et cetera. There's no going back, so it's definitely not an issue for debate, I don't think, in this review.

The business culture and acceptance of competition principles within our membership has driven change in the way the gas industry operates, as much as being driven the formal gas regulatory code and the regime. I think there is quite a dynamic development in the gas industry and I will certainly encourage you to look at the type of businesses that come and talk to you over the period of the review to indicate that there is definitely - the business model has accepted that the broad shape of the regime is very much what we're going to be living with for some time and we've certainly moved ahead of that.

I'd like now to hand over to Garth Crawford to look at a number of our specific recommendations but also deal with an initial issue that was raised in the issues paper, and that was about the costs and benefits of the Gas Access Regime. So I'll hand over to Garth Crawford at this point of time.

MR CRAWFORD: Thanks, Bill. The AGA has similar views about the costs and benefits of the Gas Access Regime as the commission did about the generic National Access Regime in a review of Part IIIA. That is, the Gas Access Regime has both costs and benefits about which all parties could debate at length, but the main focus should be on improving the operation of the regime and specific reform for that. For that reason the AGA has not engaged in a lengthy discussion in its submission of whether or not the entire Gas Access Regime has been on balance a cost or a benefit but has proposed specific ways to improve the regime.

In assessing claims about the costs and benefits of the regime, however, the AGA considers that the commission should bear a few facts in mind. These facts include that there is no counterfactual to the imposition of the regime. That is, we don't know what would have happened if it hadn't have happened. Second, that assessing the direct costs of regulation, it's possible in some cases that the substantial indirect costs of access regulation are likely to be both more significant and more difficult to quantify. Third, the Gas Access Regime was one part of an integrated package of gas market reforms and reforms to, in some cases, formerly government-owned business, privatisation and the other elements that Bill mentioned.

Fourth, the majority of benefits may have resulted from the commitment to open access rather than the implementation of detailed access pricing principles and methodologies. And this really goes back to the point that the Gas Access Regime is made up of at least three strands: open access, the commitment to guaranteed open access to pipelines; ring fencing; separation of competitive and non-competitive elements of the business and those detailed pricing elements. Also price falls to existing gas consumers are not necessarily equivalent to benefits to the community as a whole over the medium term. Finally, in a related point, economic transfers between market participants are not the same as benefits to the community.

The AGA has assessed that the direct cost of access regulation under the National Gas Code is higher for market participants and governments. The highest costs are borne at the time of the preparation of an access arrangement and the regulatory price review process that follows. The AGA estimates that around $60 million has been spent by regulatory authorities and service providers for the preparation, approval, monitoring and compliance costs related to access arrangements under the National Gas Code. It's important to recognise that some of these resources would have been expended under any alternative regime but the AGA notes that due to the higher fixed costs of preparing access arrangements under the code, a number of small distribution networks have found that the regime can impose very significant costs on a per customer basis, up to $500 per customer in some cases, and this undermines the achievement of efficient gas market growth.

A clear objects clause is one of the first recommendations in AGA's submission. The current regime has no clear or binding objects clause that defines the objectives sought by access regulation of natural monopoly gas infrastructure. Instead there are a number of potential sources for statements about the objectives of the regime set out in non-binding preambles to the Gas Pipelines Access Law, various COAG agreements and elements of the National Gas Code. This situation of having no clear binding objects clause has resulted in a lack of clarity about the policy objectives of regulation which has led to a lack of appropriate emphasis on incentives for investment in existing and new assets. This lack of clear guidance has the potential to contribute to regulatory error and failure. And on page 25 of our submission the AGA has actually proposed a new objects clause for the National Gas Code, or rather an objects clause for the National Gas Code, which draws heavily on the recommended objects clause for Part IIIA of the Trade Practices Act, which the Productivity Commission recommended late last year.

The AGA has also recommended clearer pricing principles for the Gas Access Regime. This is because there is a similar problem here as there was in the objects clause case. There are around 18 potentially conflicting considerations set out across various sections of the National Gas Code which the regulators are obliged to take into account when they are assessing an access arrangement developed by a service provider. The lack of clear and focused guidance in the regime, on the critical policy issues that are involved in access regulation, leads to uncertainty about future regulatory outcomes, a high risk of regulatory error, and discourages efficient commercial negotiations on terms and conditions of access which the regime was designed to promote.

As the Productivity Commission itself has previously emphasised, the risks of error in relation to access pricing are asymmetric. That is, the consequences and impacts on community welfare are much greater if access prices are set marginally too low than if they are set marginally too high. In the former case infrastructure will not be built or existing assets may suffer medium-term underinvestment. And in our submission we give an indicative example of the potential scope and impact of regulatory error. The AGA has estimated that even if Australian regulatory authorities, who have historically had a focus on short-term price falls and removal of a perceived monopoly rent, have underestimated the cost of capital by just 10 per cent - a modest limited error, given a low degree of statistical certainty about estimating the cost of capital for regulated businesses - this could result in an underinvestment and undercompensation on a gas network sector-wide basis of around $40 million a year.

This is another area where the AGA has made specific recommendations. On page 36 of our submission we have set out a range of recommended indicative pricing principles which once again are built on those pricing principles that the

Productivity Commission recommended in its review of the National access Regime. Another important recommendation AGA makes is to allow the service provider to choose from a broader range of access pricing models to be included in the National Gas Code. This is consistent with the original intent of the code but, due to a number of technical restrictions in section 8, currently service providers can only put forward pricing proposals based on three narrow cost-based approaches which involve concepts of total revenue and rely heavily on firm specific costs.

This is an important point because it's often claimed by regulators and users and others that the current code allows the service provider to choose whatever access pricing model they want. This is not right. Section 8.5 doesn't allow it, it actually allows only a narrow select band of heavily cost-based approaches, which were developed in the early 1980s. A broader range of costs of access pricing models would allow the better recognition of a diverse range of market contexts which Australian gas networks operate in and encourage movement to less intrusive forms of regulation, which the commission has previously supported in its review of the National Access Regime and also the review of airports. Examples of the broader sets of access pricing models that could be provided for under a revised regime are price monitoring and productivity-based approaches. Details of these and other models are described in appendix A of our submission.

Another important issue which the commission has asked for comments on is the treatment of greenfields investments. As you are aware, there is an ongoing debate and there has been a debate since the inception of the Gas Access Regime about its appropriateness for greenfields projects. Consideration of the circumstances of significant projects during the operation of the regime indicates that most new investments during that period - 1997 to 2003 - are not subject to the restrictive access pricing provisions of the regime. This undermines assertions by regulatory authorities and incumbent users that access pricing outcomes have not acted as a potential deterrent to new investment.

In AGA's view the greenfields issue has some important linkages to the issue of coverage. That is, coverage under access pricing regulation of greenfields projects is in many, if not all, cases not appropriate and this is due to four facts. Firstly, all greenfields projects are contestable in the construction and design phase. Secondly, new networks and pipelines will be subject to competition from existing field sources such as LPG, wood, fuel, oil and electricity, or indeed other pipelines in the case of transmission. Thirdly, the owner of the network or pipeline which has just been built will have strong commercial incentives to increase the throughput of gas through that network or pipeline to recover the large up-front capital investment.

Fourthly, potential users will actually have countervailing market power due to the significant cost of conversion to gas and due to the fact that greenfields network developments and transmission pipelines are typically negotiated between two or more large, well-informed commercial entities. That is, one or two entities usually underpin a significant gas network extension, they are not negotiated with thousands of customers. Another important consideration is the asymmetrical impact of access pricing regulation on greenfields projects, which the commission has previously recognised. The AGA has recommended that for those greenfields projects that do not meet any future coverage test, the regime should provide for separate regulatory treatment under the Gas Access Regime to recognise the special risks and the special nature of greenfields investments. Details of what kind of separate regulatory treatment we are advocating are outlined in our submission in section 4.2.

The AGA believes that the current greenfields provisions of the regime, in particular the competitive tender arrangements of the National Gas Code, are flawed and have contributed to the delay and cancellation of a number of significant greenfields distribution projects. Some potential greenfields projects will always be uncommercial, not economically viable under any arrangement. The AGA emphasises that for each deferred and cancelled project outlined in our submission, a variety of factors will have influenced the final decision not to invest. Bearing all of this in mind, the record of the current competitive tender arrangements contained in the code is, on any objective basis, extremely poor with no competitive tender process - none - for a greenfields distribution project under the National Gas Code so far resulting in project completion. Seven proposed greenfields gas distribution projects tendered under the provisions of the National Gas Code, with the potential to serve approximately 370,000 potential gas consumers, have been deferred or shelved or delayed since 1999; and those projects are valued at around $390 million.

In respect of the two gas distribution projects that have proceeded, one is being provided with significant government assistance to fund a user surcharge component required under the regime to make the project economically feasible, and the second was exempted from being required to hold a competitive tender under the code. The weight, number and continuing series of failed competitive tender processes under the code indicates to us clearly that the intended greenfields mechanism of the current code is not working adequately to facilitate new investment.

The AGA's perspective is that for non-commercial projects there may always be a role for transparent government funding of projects judged by the community to be important, on the grounds of regional and state development or increasing fuel choice in regional or outer urban areas. The Victorian government's most recent package of $70 million over four years, in support for regional gas extensions, is an example of this and is supported by AGA. We are keen to ensure, however, that as far as possible the Gas Access Regime encourages all commercial greenfields projects, reducing the need for ad hoc funding of particular projects by state government taxpayers. To the extent that the regime can provide improved treatment which sees a direct beneficiary of fuel choice and lower fuel costs contribute towards greenfields projects and reduces the need for and level of these state government interventions, it should.

On the issue of coverage the AGA has proposed a higher bar for coverage under the Gas Access Regime, a position which is consistent with the Productivity Commission's recent recommendations on the need to clarify and better target the coverage test in section 44 of the Trade Practices Act, which governs declaration. The AGA considers that some assets have been inappropriately covered under the existing regime and believes that, due to its significant costs, access regulation should only be applied where it has clearly been shown to be necessary. This inappropriate coverage of assets has, in AGA's view, been driven by an interpretation of the current coverage criteria by the National Competition Council, which is inconsistent with the policy intent of governments when they constructed the regime and which does not adequately recognise the competition faced by gas networks and pipelines from other fuel sources and, in the case of transmission pipelines, from other competing pipelines. On a final issue we will talk with you today about the Epic Energy case, and Bill Nagle will take the lead.

MR NAGLE: Thanks, Garth. Just to re-emphasise a point I made earlier, although our submission is long and detailed, each section follows the discussion paper quite closely. It sort of defines what the issue is, it discusses the merits and problems that we found under the current code and makes very, very specific recommendations, even to the point of actually rewriting parts of the code and the regime and also layers through it quite a lot of examples. The types of distribution businesses that Garth referred to in there about the competitive tender processes, these aren't assertions we make; we actually list them all out in a great deal of detail in the submission.

Given that we are here in Western Australia, obviously the panel is going to hear a fair bit about the Epic Dampier to Bunbury Natural Gas Pipeline case, and therefore we thought it would be remiss of us to avoid making some comments on it, controversial as it is. Elements of the Epic Energy case, and that particular pipeline I'm talking about is an important case for the development of the Gas Access Regime. But what was important about it, from the point of view of the operation of the regime, was the legal and economic principles which were discussed and debated in the court case, not necessarily the commercial debate about what they paid and whether or not they are going to be able to recover it and what the tariffs are that are being set by the regulator.

The particular facts and claims highlighted by that part of the commercial debate that's been going on, in fact, in our particular point of view, are very much a distraction to the purposes of this inquiry, and I hope that the Productivity

Commission review won't get too diverted by the commercial debate that surrounds that but, if you do want to look at the case, clearly the legal aspects and the economic aspects that were thrashed out in the court case are quite useful.

The importance of the court case is that it was the first court case to actually examine the guidance to regulators in the existing code. We talked about, up-front in our submission, the objectives of regulation and pricing principles - those sorts of guidance elements of what sort of policy imperative is embodied in the access regime in the code that regulators and regulator businesses and users can guide their ship by.

The Epic case was quite important in that regard because it was the first case that actually examined the guidance elements of the code and the interaction of pricing in other code principles. What the court found - and so I'm talking about the court case, not about the regulator's draft decisions and final decisions here - was a confusing and complex interplay between various sets of guiding principles located throughout the Gas Code, which is one of the reasons the AGA has recommended to this review clearer and more consolidated regulatory guidance, including a binding objects clause and one set of pricing principles right up-front.

The other important element of the case is that the judgment better defines the standard of competition that access pricing regulation should try to achieve. It says that access prices should reflect outcomes similar to those which would occur in what's called a workably competitive market, not a theoretical abstraction of a perfectly competitive market which regulatory decisions we believe, up to this point, have sought to reference. This concept of a workably competitive market is a very useful one for this inquiry, and it also builds on similar findings made by the Productivity Commission in the review of the National Access Regime report about the high and asymmetric risk of regulatory error and underinvestment, which arise from trying to set access prices with the levels of forensic accuracy which are not supported by market evidence or existing pricing models.

The AGA considers that there are a few facts about the background and outcomes of the Epic case which the commission should be particularly aware of to counter any misconceptions about the case. First, as far as the AGA is aware, no party to the action ever claimed that the regulator or court was bound to accept an asset valuation equal to the purchase price of the asset paid by Epic Energy; second, the outcome of the Epic case provides no support for such an argument; and third, the regulated gas businesses would reject the proposition that regulator tariffs should simply be calculated on the basis of the purchase price paid for an asset. As the court judgment makes clear, this is simply one of a number of relevant considerations.

Given these points, we would certainly urge the Productivity Commission to focus on the economic and legal principles examined and established in the case and not be diverted into particular contentions made about the commercial impacts of the access arrangement decision, claimed commercial and political understandings that lie behind the purchase of the asset, or the direct financial interests of the individual parties in the case, including obviously gas users. That concludes our formal presentation this morning and we're obviously happy to take any questions and discuss any of our formal presentation with you. Thank you.

MR HINTON: Thank you very much, Bill and Garth, for that presentation. I also want to thank you for your submission. We do appreciate that the deadlines were very tight from issues paper to public hearing and that put pressure on a whole range of companies and entities as to getting in a submission prior to a public hearing, so we thank you very much for the efforts you've made and also in giving us that draft statement in advance that helped us to prepare for this morning.

In terms of where to now, I'm sure we could spend the rest of the day at least on your extensive submission and also the issues you raised in your introductory statement. What I'd like to do with Michael is now try and explore some of the key parts of your introductory remarks and your draft submission. Let me start off with your comment that - I think it was Bill's comment that said we can't go back; that you're not seeking to start afresh and not have intervention, not have regulation of the kind that's inherent in the Gas Access Regime. I've got two aspects I'd like to explore with you here. Is that because the industry has certain characteristics that warrant some sort of regulatory reaction, action by government? Or is it more mundane than that; that we can't reverse politically or process-wise a system of regulation by government?

But a related point is whether or not the industry today is significantly different to that which applied six or seven years ago, when this initiative was taken. I think there are tensions in those points that I'd like you to explore for me, as to what underpinned your statement that we can't go back.

MR NAGLE: Yes, it would be easy to say all those points actually come into play. The initial reason I made those points was that I wanted to kill off any perception that the AGA or its members were seeking to remove open access as a feature of the gas pipeline and distribution systems in Australia - I mean, there is absolutely no objective in that at all - also many of the other aspects of the code. Basically what we were saying was that the nature of the bottleneck or monopoly assets, or whatever you like to call pipelines, will always mean that there will be some sort of regime in place for ensuring open access and third party access for users; that's all part of the great adventure we, as a country, took off on in the early 90s for national competition policy reasons and those objectives are strongly supported by the AGA and our members. So it's not really just an acknowledgment that, "Well, this system is in place and therefore we have come to begrudgingly live with it."

I think the nature of the industry is very, very different from what it was back in the early 90s. We had integrated utilities, gas utilities, some of which were owned by governments - not all, but many were owned by governments - and they sometimes had transmission, distribution and retail aspects to their businesses, sometimes distribution and retail. Many of those have been sold off and separated out. The old utilities now have retail and distribution arms; some of those completely separate. Some of our members just own distribution businesses alone and don't own a retail arm and have absolutely no interests in the retail side of the business. Others have retail businesses, but those retail businesses historically have existed in the same geographical location as the location of the pipes - ie, the distribution businesses. That's all gone now. Those retailers are free to operate anywhere around Australia in the main, and they are interested in open access by themselves.

So each of our member companies essentially have a geographical footprint in terms of where their distribution systems exist; some have got related retail businesses, where they are getting access to their own pipes and their competitors' pipes, or in other states, and some of their retail competitors are getting access to their pipes. It's a system that now exists and it's a good economic outcome for the country. What we're actually arguing about is that one throw of the dice back in November 1997, when the code was written and introduced, was not - no-one could ever claim that we got every single aspect of the regime correct.

What we're seeking to say is, "There is the regime, let's go now and have a look at it after five or six years of experience," and starting from the top we believe the objectives are not clear, the pricing principles are certainly not clear, the type of pricing methodologies that are open for people are restrictive and the issue of - so that's that debate. There is very much an issue, like Garth said, of coverage. There is a regime in place which will catch many of the assets, the pipeline and distribution assets, which should not be covered.

But right at the front of the regime is a gate which talks about whether or not the regime covers your particular asset or not, and there's a range of tests involved in that. If you meet those tests then you are covered - no dispute - hopefully covered by a more enlightened code, but covered nevertheless. If you don't meet those coverage criteria then you should not be covered, because the code was created to create an "as if" competitive outcome. If that competitive outcome is being created by competition, either with other pipelines or with other fuels, or the nature of the foundation contracts or whatever, then the pipe should not be covered. That's essentially what we're saying.

MR HINTON: Thanks, Bill. I want to get onto coverage and the objects clause in detail in a minute but, in terms of setting the scene, behind my previous question was whether or not your proposed refinement to the access regime was being driven only by the experience of the code over the last X years, or whether or not in fact it also reflected that the industry had shifted as well. It was those two forces at work that were behind my question. As I understand your submission and your introductory statements today, you put much more weight, if not only weight, on the experience of the code today. I'm really trying to explore with you whether or not in fact the nature of the industry today, the investment that has occurred, the relationship between transmission and distribution, with its expansion of interconnectivity - whether or not those factors also need to have some influence on the shape of the code down the track.

MR NAGLE: Yes, and I think we were probably remiss by not referring to some of those, but certainly the nature of the industry is very, very different. Some of our businesses - I mean, all the businesses nowadays look very, very different from what they looked like back in 1995, 96, 97 when the code was being negotiated. Some businesses are purely distribution and transmission businesses, so they're tollways. They love throughput; that's what they thrive on. There is no sort of game in terms of market share protection or whatever, so there is quite a different aspect to the industry. Also, I think the issue of third party access and open access was a fairly novel concept in the early 90s, with telecommunications, airports, rails, ports, wires, pipes. It's very much more established now as absolutely central to the way that modern efficient economies run. It's modelled all around the world, so certainly the nature of the industry has changed.

MR HINTON: Thanks.

DR FOLIE: Following in the same sort of theme, in your introductory remarks - again, on these about there being total agreement now about open access, ring fencing and even broadly pricing, but an element that has actually changed the industries - the rules of how the industry operates, which the code brings in through these things - has actually shifted from where it was pre-97 - in other words, requiring that.

To what extent - and this comes up to Garth's area about the benefits - by crafting the rules appropriately, to what extent do you need to have the stick about prices, the final one? In other words, if you can't close on price as well, then you may never get a deal? But to what extent are you implying that really a lot of this could actually be done without the heavy pricing stick? You would actually get outcomes, because changing the rules under which the industry was structured, the way it had to operate in forcing people to have open access and also the ring fencing that reinforced it - to what extent is that the important driver, and then the complexity and a lot of the dispute in the code and the time delays really result in actually the pricing debate that also follows?

MR CRAWFORD: Yes, that's true. I think there was a lot of concern at the beginning of the code about the potential interplay between retail and distribution, owners of pipelines, owners of distribution networks and retails and the potential anticompetitive conduct that could happen there. But as Bill has outlined, the market structure has changed so much that you now have pure play distribution businesses and pipeline businesses that have absolutely no commercial interest at all in restricting access, and no commercial interest at all in trying to restrict access through high access prices. So those two elements of ring fencing and open access, I think, are well settled and have to some extent also contributed to the driving changes in the industry and access pricing regulation, to our view, should be that last stick in the cupboard - the very last resort due to its high potential cost and the asymmetry of those costs as against those other two elements of guaranteed open access and ring fencing.

DR FOLIE: So to what extent then - I mean, because all of the elements of the code are put in there as a result of very complex negotiations, do you think the industry could agree if we then got a good objects clause that you could simplify, and the access requirements are there - could you actually simplify in some way section 8, the pricing area, or is that a big ask?

MR NAGLE: I think if you get the objects and the pricing principles and the coverage, so once you're in there is a very good reason why you're being covered. Our proposal actually in a way is to add a greater range of options under section 8 for the pricing principles. Garth talked about there being a sort of quasi choice there of the type of pricing models that the service provider - the pipeliner - can voluntarily use as a framework for their access arrangement, but in fact if you look at section 8.5 of the code, it clearly says that irrespective of the fact that you've got some choice, you have to structure any of these choices as if they're a cost-base building clock approach as outlined above in the section above, which basically says, "You can have your choice, but you can't use it," like the Henry Ford choice of the T-model Ford - any colour as long as it's black.

Basically if you have got the access pricing principles and objects clause right and you have a sensible choice of type of pricing models you can have then, because of the fairly wide array of the nature of the businesses we are talking about here - they're no longer all integrated utilities - they can present access arrangements based on a pricing model that makes sense to that nature of the business. The complexity of the businesses that we now look at is very, very different from 95, 96, 97 when we had this sort of simple building blocks approach, which was almost like guilt - there was an assumption of guilt beforehand; therefore, you had to throw all your costs open and you built up basically your tariff on the basis of you know these are your revealed costs and therefore that's your tariff. What we're actually saying is that if the code can now mature beyond that, have greater choice of pricing methodologies, the regulators and the public can feel a lot more relaxed about it because the nature of the industry has moved on.

MR HINTON: Let's go down to some of your recommendations - and I have in mind here looking at the objects clause and we'll also look at coverage and look at your alternative forms in appendix A. Given the available time we've got left, let's start off with the objects clause. You give significant importance to having an objects clause with clarity. I would be interested in your views on the nature of the existing access regimes in terms of objectives; whether or not there are different aspects of it, such as preambles, such as guidelines, such as principles, as well as an overall objectives clause, and whether or not it's the hierarchy of the access regime at the moment that is also important. I would like elaboration in effect of your thinking about the objects clause.

MR CRAWFORD: That's front and centre of our recommendation to have one clear set of binding objects clause at the beginning of the code, so that no-one can make any arguments about what the true objectives of the code are because, although there are objectives, like clauses, floating around in all sorts of documents - the Gas Pipeline Access Law, the Natural Gas Pipelines Access Agreement in 1997 and, some have argued, section 2.24 is a de facto objects clause. Others have said section 8.1 in the pricing provisions also sets out objectives.

You've got all this extrinsic material and no clear basis on which regulators - and not just regulators, but also commercial parties who may seek to undertake commercial negotiations with access seekers and the owners of the assets. All these parties are labouring under the potential of not having a clear idea of what governments impose this regime for and what it was designed to achieve and how the provisions of the code under this objective clause should operate, so they're all suffering under this huge disadvantage of having this range of concerns, so our approach has just been to establish one binding objects clause which could then be referred to by regulators, access seekers, owners of assets and other parties, and facilitate more efficient commercial negotiations and better outcomes under the regulatory regime in general.

MR HINTON: I'm a little puzzled by some aspects of your formulation; for example, you have a negative objectives part of the objectives clause; that is, you say what it is not.

MR CRAWFORD: Yes.

MR HINTON: It's not a flippancy. It's a question of whether or not that does bring clarity. There are lots of things the Gas Access Regime should not be. It seems prima facie to be not useful to start to list those things it's not meant to be. I would welcome your comments on the origins of item (c) of your - - -

MR NAGLE: We had quite a debate about this in terms of - there is a commentary around that recommendation about seeking to work in the term 'workable competition' that came out of the Epic case.

MR HINTON: Yes.

MR NAGLE: There were a couple of formulations you could have, either in the positive or in the negative. The major issue was in fact that we believed that there was this slavish adherence to what was seen as a perfectly competitive model - a market model - that the regulators were seeking to replicate in access pricing.

MR CRAWFORD: I guess it's a sensitised point because it's built on the experience of regulated businesses under the code where they read in regulatory decisions such phrases like "revenue should be just sufficient to ensure continued service provision" and for a network long-lived capital asset, like a gas pipeline network, you could arguably stop revenues tomorrow and service provision might continues for a few more days. It doesn't make sense and it reflects a sort of a theoretical, precise model of exactly what a competitive market should result in.

Another example is the ACCC's draft greenfields guideline, where they make the statement that, "In theory you would suggest that a negotiated tariff would reflect the reference tariff and any variance upon that would be an exercise in market power by the service provider," and what we are trying to emphasise is that actual outcomes of these workably competitive markets fall within a band - they're not a precise-point estimate - and so that's what we're really just trying to re-emphasise.

MR HINTON: So that in effect provides an umbrella comment that can then be commented on when you get down to the next level of guidelines or principles that might be specific parameters for a regulator to operate under.

MR CRAWFORD: That's right.

MR HINTON: Let's move on to coverage. You also talk about a higher bar only where necessary. I would be interested in the sorts of principles that would underpin a higher bar. What sort of criteria do you think should apply with regard to coverage in circumstances where you were critical in your introductory remarks about "the NCC does not recognise competition in the current environment as well as it should".

MR CRAWFORD: Yes.

MR HINTON: Can you elaborate on that, please?

MR CRAWFORD: Yes. The recommendation we have made is to insert a substantiality or materiality element into the coverage criteria, but really you have to look behind that for the case law about what exact type of assets do we want to cover and why do we want to cover them? We'll just point out that there are a few environments where coverage adds no value to the regime and, due to the potential cost of regulation, will actually be a net negative effect, and so the type of instance we're talking about is where two or more pipelines compete for an end market; for example, the Moomba-Sydney pipeline and the eastern gas pipeline - and this is increasingly happening around Australia, particularly in state capitals, where historically they were served by one pipeline from a production basin, but now they are being served increasingly by two pipelines. Another example of the type of situation which may fall outside a boosted coverage test is a greenfields distribution network or pipeline serving a regional area.

MR HINTON: Can we put greenfields to one side for the moment?

MR CRAWFORD: Yes, sure.

MR HINTON: We would welcome your further comments on the greenfields issue, but let's stick to coverage in terms of existing - - -

MR CRAWFORD: Yes, or even an element of recognising inter network competition or facilities-based competition between gas and electricity, for example. In an increasing range of commercial and residential applications gas and electricity are substitutable over the medium term, so we believe that the regime needs to better recognise the developments in competition between networks over the next five or 10 years in a forward-looking way rather than just reflect a historic backward view that these pipelines were always regulated and shall always be regulated.

MR HINTON: Would you look to have a separate set of criteria with regard to the distribution network relative to a transmission pipeline in terms of coverage? Do you think that the access regime can be sufficiently flexible to do that implicitly or do you think there should be explicit parameters in each case?

MR CRAWFORD: No. We actually feel the existing coverage test is flexible enough to do that because the two principle legs upon which many pipelines and networks have gained revocation under the regime is the market power test and also the costs and benefits test, and there have been a substantial number of gas distribution networks, principally serving small regional areas, which have applied to the National Competition Council; the National Competition Council has recommended revocation, and that has gone forward, so we believe the test - a slightly amended test - is wide enough to encompass both classes of assets.

MR NAGLE: Yes. We wouldn't like to see the code being broken up on any of the key elements of it. I mean, objects, pricing principles, pricing methodologies or coverage test - we think that the economic and legal cases between the distribution and transmission are exactly the same. There are clearly some operational aspects and I think over time you might get a different type of outcome in terms of what is covered, but the test can be the same in that you can have competing pipelines going to a single market. You're unlikely to have competing distribution systems, so there's - you don't need to establish a different code or different types of coverage tests for that. It's picked up in the assessment under the criteria - - -

MR HINTON: So the conceptual and policy framework for distribution and transmission you see as being the same, but the operational details as to judgments about market power might vary across distribution versus transmission.

MR CRAWFORD: That's right.

MR NAGLE: Garth mentioned a couple of comments there that some of the small regional distribution systems have successfully gone through a process of revocation, mainly because of the cost and benefits of formally regulating that piece of asset - ie, demanding an access arrangement - and the judgment has been, "Well, they're too small. The cost per customer is just too high." On the other issue about competing pipelines, head-to-head competition - well, you're unlikely to get a small regional distribution system, or even a large city one, competing with an alternative one - pipelines, yes, but they're all picked up under the same terms.

We went through this exercise of looking at the code and saying, "Is there a case for having two codes - one for transmission and one for distribution - or having one code and, as you come in halfway down, you go left for the distribution or right for the transmission." Virtually there was a very small hatful of issues which might only apply to transmission, but not distribution or vice versa, and it's the judgment of our members, both on the transmission and distribution side, that there is no agenda for separating the code into two parts, and the subtleties of the different operations can be picked up in the coverage test and in the types of access pricing principles that the regulated asset chooses to use as its framework for presenting an access arrangement.

MR HINTON: I think you have both referred on a number of occasions to the context of this inquiry - the background being also the Commission's review, evaluation, in Part IIIA. The Commission made certain recommendations to which the government has made an interim response, and one of the issues that arose there was the question of substantial versus material. We need to revisit that issue with regard to - and this is of course pertinent to the coverage issue we are on at the moment. I would welcome your views on that issue. Material prima facie is significantly smaller than substantial. We'd be grateful for your reactions.

MR CRAWFORD: We've been through a similar debate, following the interim Commonwealth government response, leaving some of the members to ask about the materiality of this materiality debate. On balance we came to the view that we supported the Productivity Commission's original recommendation for substantial increase in competition, simply on the basis of minimal disturbance of case law, which has built up around the coverage test, and also we were unable, with the time we had, to find any definitive legal view about the differences between substantial and material, so we went with substantial.

MR NAGLE: The substantial focus is enshrined in our recommendation to you.

MR HINTON: You've referred on a number of occasions to greenfields. Let's explore that issue. In effect you were expressing a view about the non-coverage of a greenfield investment for a certain number of years. I think, if I recall correctly, your submission refers to up to 20 years. Can you explain your thinking behind that and how that sits or how the ACCC guidelines sit with that sort of view that you've expressed in your submission?

MR CRAWFORD: We adopted that position on the basis that 20 years is a normal project and financing time line for a gas distribution network extension or a significant gas transmission pipeline. We adopted the approach of recommending as one option an access holiday or economic regulation-free period because it's our judgment that, given the contestability at the design phase - that is, anybody can build a pipeline in Australia; anybody can build a network extension - there are no exclusive franchises any more. Due to the inter-fuel competition, the competition which the pipeline or network will face from other fuels, due to the significant commercial incentives on the new asset owner to maximise throughput to try and offset the large capital outlay which happens in the early years, a 20-year access holiday was appropriate.

Our judgment was that if large and small customers, particularly in regional Australia, have new access to a new fuel source, competition from gas and electricity, then that can only be a benefit. The exercise of any market power or monopoly power just isn't an issue in a greenfields environment. So that underlies our approach on that point. In response on the ACCC's draft greenfields guideline, the point I'd make is that there's a lot of description in that guideline about approaches that regulators could adopt. Regulators currently don't have the power to make binding pre-investment rulings on approaches that they will adopt. Really, to our mind the guideline demonstrates the wide discretion that is available to current regulators under the current regime about approaches they could adopt to all sorts of issues relating to costs for capital, future demand, incentives, efficiencies and the asset value.

MR NAGLE: Yes, so rather than reassuring the asset owner or the investor, it just reinforces the point that once the investment goes in the ground then there's a great deal of discretion there that can be imposed on the asset after the investment decision is made, which upsets the assumptions on which the rate of return or the return on the investment is predicated. The access holiday issue was a recommendation also of the energy market review report, the Parer review. It was an issue that exercised that inquiry quite a lot as well. They came up with 15 years, I think, but we believe the 20 years is a little bit more commensurate with the gas infrastructure project financing time lines.

MR CRAWFORD: There's a real risk, if you set the time line too short you're effectively giving an access holiday or an economic regulation-free period to the normal period of early losses in a project, in which case that actually has no role in encouraging and facilitating new investment at all. It simply covers them from access regulation in a period where they're making early losses anyway, so it's of no benefit, so it's very important that the time period is right for that.

MR NAGLE: It's a good point actually because one of the problems that we see with this whole debate about access holidays is that, although we see it as a very useful regulatory tool that can be used, we don't want people to think it's a magic bullet and you can solve a lot of problems here. You can have an access holiday for a period that's too short. Essentially what that does is just give you a holiday for a period in which you're going to be underwater on the project anyway, which one would assume regulators would reflect in their types of decisions. Just by saying yes, we'll have an access holiday for a certain number of years, isn't a solution in itself. You need to have it at a significant period so that it actually does cover a period where returns becomes positives as well, so there is some clawing back of the early losses.

MR HINTON: But presumably you're talking transmission rather than distribution here.

MR CRAWFORD: No. Actually we believe that the model is equally appropriate for a distribution network. For example, distribution network extensions in Victoria are usually underwritten by one or two large customers to negotiate on a commercial basis between the relevant network service provider and the commercial customers. They're both big and ugly enough to look after their commercial interests. What happens generally is under those network extensions those go to the large commercial customers - one, two or three - first and then that underpins a rollout to the urban investment, to the belated small towns and the small customers later on. So it's still that dynamic of a competitive commercial bargaining process where each has countervailing market powers, so we think it's appropriate for both.

MR NAGLE: You don't build gas distribution regional extensions on the basis of the households. You build it on the basis of a small number of major foundation contractors. They may not be power stations or large mineral processing plants like come off transmission pipelines but they may be a food processing plant, a hospital, a bakery, glass plants; if it's a highway town, a couple of big takeaway restaurants or whatever - those sorts of things. Therefore, you've got the similar dynamic between the pipeline and the distribution system. This is one of the reasons why governments in Victoria and Tasmania are throwing large amounts of public money at these regional distributions because it's like a quasi formula that can overcome all these other regulatory problems. We've never asked any state government, ever, to throw money on the table to get these projects up. It's their way of externalising a whole pile of regulatory problems that for some reason they're loath to deal with directly.

MR HINTON: You mean regulatory problems or other wider objectives?

MR NAGLE: There might be some social welfare objectives as well, but there's a whole range of issues about - you know, our members would dearly love to build - that's what they do for a living. They build distribution and pipelines. If there's a case to be made, a commercial case, they will do it. But that's modified in many, many cases because of the lack of security about recovering expenditure and investment.

DR FOLIE: Thank you very much for providing some alternative access pricing approaches. I'm cognisant of the time but I would like to ask you a question that probably is incompatible with the amount of time we've got. Broadly, what would the code look like if we went to each one of those?

MR CRAWFORD: Firstly, the way we would envisage the code looking is having a binding objects clause up-front, the pricing principles and a reformulated pricing section of the code - hollowed out, if you like, some of section 8 which says clearly that the service provider has the right to choose, to select and propose an access pricing approach which is relevant to their network characteristics, their network history and circumstances. The code would thereafter set out in a descriptive way some of the key elements of each of those models which we've outlined in appendix A: price monitoring, price service offering, productivity-based indexed approach and sharing of benefits cost-based approach, and would retain the existing cost-based approach because some service providers somewhere may actually want to do that for a particular reason.

It would set out that choice in clear terms, describe - but not in the prescriptive way that the current section 8 describes every single mechanistic thing that you have to do under the cost based system. The service provider would therefore work up an access arrangement which is underpinned by one of these access pricing approaches and would go to a regulator and essentially say, "This is my access arrangement. I've selected model X as being the appropriate one," and the service provider would propose that to the regulator, and the regulator would judge that against two criteria: does it meet the objects clause of the National Gas Access Regime? Are its outcomes consistent with the pricing principles which have been revised under this review? If it met those two keys tests, then the regulator would approve that, and that would be the model in operation for that particular gas distribution network of pipeline.

MR HINTON: So your appendix A is not alternatives but choices for different segments of the industry.

MR CRAWFORD: That's right. It's a broader range of choices.

MR NAGLE: Under the code at the moment under section 8 it basically envisages like a multiple-choice model that basically says that - under the reference tariff principles part of section 8 says:

> Principles for determining total revenue. The reference tariff principles specify three methodologies for determining the total revenue, cost of service, internal rate of return and net present value.

It talks about them a bit more, then it says:

> Other methodologies may be used, provided the resulting total revenue can be expressed in terms of one of the three methodologies described above -

which basically in a practical sense, in all the applications that we've ever seen, means you've only got those three choices, which are all essentially variants of the same type of model anyway.

So our argument would be that you need to change a lot of it. You can just say that the reference tariff principles can be specified under a range of methodologies; list the five or six ones out. These aren't a textbook on how they work. There's only a couple of paragraphs on them in the current code. We spelt them out in some detail in our submission just to give people a bit of a flavour of what they were. You wouldn't embody, I don't think, all of that wording in the code but you'd refer to it. These are all established methodologies which are used somewhere around the world or in Australia under different sort of asset classes.

MR HINTON: But if you've got a higher bar for coverage, you're then seeking to have options - say your appendix A listing of five categories. You'd have a higher bar but within that category of subject to coverage you could perhaps even have one activity subject to price monitoring, so you've got a higher bar with lighter-handed intervention.

MR NAGLE: Yes, that's right. With a higher bar then a number of assets may not be covered. Ones which are covered, some of those ones might actually be, if you can use the term, just covered for whatever reason and they may choose to have - - -

MR HINTON: Price monitoring.

MR NAGLE: Or anybody actually. Even if you think there's a very good case for covering them, they can choose to elect price monitoring.

MR CRAWFORD: It's about recognising the different circumstances. For example, the Queensland gas distribution network is one of the smallest in Australia. It was built essentially by the state government. It's a very lowly-utilised network because there isn't a lot of heating load in the residential and commercial areas. There's intense competition with both LPG and electricity, and in those particular market circumstances, although it may meet a higher coverage test, price monitoring may be exactly the right approach - the lowest cost approach to actually ensuring there's no scope for abuse of market power.

DR FOLIE: You mentioned right at the beginning of your speech, Bill, that ring fencing is - there's no debate that it's effective. However, there is some concern amongst some of the regulators that effectively associate contracts may be a way where you can actually sort of offset some of the disadvantages of ring fencing, clearly having this demand of regulatory accounts coming from Queensland. Would you like to actually comment about this debate that's occurring and what - - -

MR NAGLE: I think it's a pretty healthy debate. It was always envisaged under the code that the sort of issues would be ring fencing and treatment of associate contracts. We're going through that process. We're not recommending in our submission major surgery on any of those aspects of the code. Clearly we've gone through it and come up with 10 high-priority issues. There will be a debate. At times it will be nasty and sharp but it's just one of those sorts of things. The ring fencing provisions are accepted, our members - we've quizzed them on this time and time again. Is it an issue for the review? No. It's certainly an issue for a practical implementation issue of the current code.

You know, there are all sorts of debates that we're having, but at the end of the day the framework is essentially something that people are reasonably happy with. We've actually gone to it very briefly at the end of our submission where we were asked to comment on some other matters. I don't know if you want to hear a couple of words on that. Garth, do you want to - - -

MR CRAWFORD: I guess just in relation to associate contracts, we did pick up a couple of operational issues about how those contract provisions are being applied under the National Gas Code currently, and there have been some delays and questions about the application of what is an associate contract. We are keen for the Productivity Commission, government and policy-makers to understand what the policy objectives of associate contract provisions were, because we have had an example where there is some degree of slippage in the definition of an associate contract, where some regulators are seeking access to service agreements between the asset owner and the asset operator - two functionally separate bodies. One essentially is contracting with the other to asset manage for them.

That clearly is not an associate contract of the type which governments and policy-makers sought to have covered under the original regime. The associate contract issue was principally an issue about related entities downstream in the market, for example, between a gas distribution network owner and an associated retail party, and those contract provisions are important to give other retailers, who don't have an associated network owner upstream, for example, confidence that they are being dealt with on an arm's length basis with other retailers, for example. That's an important policy objective and we have no issue with that but we do have an issue with service agreements being redefined as associate contracts where there is actually a contestable market for asset management services and arm's length transactions happening there.

MR HINTON: I am very conscious of the time. I'm sure we could keep going, but we can't. Let me seek one last question and it's coming back to that appendix A listing of those five alternative access pricing approaches. There is quite a wide range of options there - you've already referred to price monitoring - up to more heavy-handed intervention, regulation. The question here then becomes what criteria would be applied by the regulator in choosing which particular formulation to which particular asset? What would be the sort of overriding parameter that he would want to look at to make a judgment about which alternative?

MR NAGLE: The choice is for the service provider to make that choice. I mean, if you're covered by the code and you have clear pricing principles, then you have the opportunity, the service provider, to the pipeliner or the distribution company, to choose from that range; just like we currently have in the code, where there is a quasi multiple choice option there and a service provider, the regulated asset, chooses. But whatever they choose and however they construct the access regime, it has to be consistent with the pricing principles. Clearly, if there is a multiple choice - I mean, obviously the access service provider will do something that suits the particular circumstances of their company, be it because of the particular nature of the Queensland system or some of them might be happy with the current cost-based systems because of historical reasons, and they would do that.

Remembering that this is an absolutely fundamental part of the original agreement, the owner of the asset gave up a large slice of their property right in November 1997 when they were covered by the code, to have open access. They actually gave it up and you shouldn't underestimate what they have given up there. They have given up a huge amount of control over an asset they own privately, but they did it because it was consistent with National Competition policy principles and it was their concession for part of it. Part of the alternative, part of that negotiation, was that the service provider has enshrined, in the political agreement around this, the right to choose the type of pricing methodology from the code to build up their access arrangement. We don't see the circumstances are any different today than they were in November 97.

MR HINTON: Thank you very much for that. Thank you again for your attendance today and your submission. We really appreciate it, and it is important, this sort of participation.

MR NAGLE: Good, thank you very much, sir.

MR HINTON: We will now break for a short morning tea session and return at 10.45. Thank you.

MR HINTON: Good morning, again. We now move to the second session for this morning session on Monday, 1 September, in Perth. I now invite Alcoa to come forward to the microphones. Ms Lesley Jefferies and Mr Mike Shaw, welcome.

MS JEFFERIES: Thank you.

MR HINTON: I think you missed my early morning introductory comments but informality is the way to proceed here, though I remind all present that there is a transcript being taken. You don't need to take an oath, but we expect honesty, naturally. I would also like to not only welcome you to this session of the public inquiry but thank you for your written submission. Thank you very much, we appreciate that. What I'd like you to do is to identify yourselves into the microphone, name and where you're from, for the purposes of the transcript and for clarity of the microphone for the transcript, thank you very much.

MS JEFFERIES: Okay, Lesley Jefferies. I'm manager, raw materials and energy for Alcoa World Alumina Australia, based in Perth.

MR SHAW: I'm Mike Shaw, also from Alcoa, procurement specialist, energy, also based in Perth.

MR HINTON: Thank you very much for that. I've already referred to your submission but I'd like to invite you to make an introductory statement for this session, to get proceedings under way for this session.

MS JEFFERIES: Okay. I guess Alcoa would like to state that the submission we've made is really just a preliminary submission and we expect to make a detailed submission at a later date, if that's okay with the commission. Just to talk in generalities mainly about Alcoa, some of the detail we believe will need to be confidential and that will be covered, we believe, in our detailed submission. We're not in a position to talk about detailed commercial arrangements, but we do think that there are some comments that we can make that are quite okay to be in the public domain.

Just to give an overview, Alcoa is the largest user of natural gas in Australia. Alcoa's alumina operations in the South-West of the state produce about 16 per cent of the world alumina production and with Worsley as well it takes us up to about 22 per cent of world alumina production. We've been here in Western Australia for nearly - well, in fact it is the 40th anniversary this year, so Alcoa has been here for a long time. I know that Alcoa's alumina operations in Western Australia are in the lowest quartile for a cost perspective, mainly because of the low cost we pay for bauxite, which is also a very low quality - but that's another issue - and I guess the second reason is because we have competitive energy prices, and the third one is because there's long-term stability in Australia and Alcoa is quite comfortable investing billions of dollars in infrastructure because of that.

The main reason we'd like to make the submission is around the ongoing sustainability of the energy we require for our operations. I'd just like to reflect on that for a little bit. The alumina process, for those of you who aren't familiar with it, is the Bayer Process that requires steam to dissolve the bauxite into the caustic, and the process has to be kept hot at all times. Not only do we require competitively priced energy, we also require that the energy be available on a continuous basis, and that cannot - unless in an emergency with plenty of prior warning - be interrupted or the situation is catastrophic for our refineries. If they are without energy for more than about 12 hours they run the risk of never being able to operate again.

MR HINTON: Thank you very much for that, Lesley. In response to your reference to a preliminary submission foreshadowing a more substantive one down the track, that's fine. In fact, we would welcome a follow-up submission from you and look forward to getting that. In fact, the benefit of this public hearing and your attendance today could help refine and develop your follow-up submission.

You also refer in your remarks to commercial-in-confidence matters. The commission is very mindful of the reality of the sensitivity of commercial-in-confidence. There is scope for commercial-in-confidence hearings, where the room is closed and you participate in a public hearing totally in camera, and we're very comfortable to put that in place if that is your wish. We certainly don't wish to compromise commercial imperatives for any participant in a Commission inquiry. We test quite substantively the nature of commercial-in-confidence submissions when interested parties seek that. Sometimes they like to say things and pretend that they are commercial-in-confidence when they are not, so it is a substantive test, and that's not in any way to suggest that yours wasn't - on the contrary.

MS JEFFERIES: I understand that.

MR HINTON: It was a general comment about how we operate. We're certainly very conscious of and sensitive to that particular parameter. Thirdly, it's very important that our inquiry seek, obtain and get input from all segments of the sector and so we welcome Alcoa's participation as a particular player in a particular part of the sector that is important to bring another perspective to the operations of the Gas Access Regime.

I'd like to follow up initially a couple of points regarding your written submission. It's in brief terms, in summary terms that you refer to the impact of recent events on not only Alcoa's activities and commercial operations but also on the economy of the state of Western Australia. The two factors that you flag are: one is the privatisation of the DBNGP, and secondly, the significant change of the application of third party access code to that pipeline. I'd like you to elaborate a little on that statement, and particularly if you can segment it, differentiate into the effect on you and effect on the operation of the state. That might be useful for us.

Particularly I have a reason for asking this in that I want to explore with you the effects of the code or the Gas Access Regime on those outcomes - that is, Alcoa and the economy of Western Australia - and other factors that are clearly running and affecting the overall environment that Alcoa operates in and overall activity of the economy of Western Australia. A sort of disentangling of those factors is what I'm after. It has not always been clear in a number of submissions how well that can be disentangled. We're assessing the code. There are many other factors out there affecting the economic environment. So that's why, with a rather lengthy introduction to my question, I would welcome your comments on those reasons, or those factors.

MS JEFFERIES: Thanks for the question. From our perspective it is very difficult to disentangle and we didn't endeavour to do that in the preliminary submission; we just recognised that the third party access code has impacted, as well as privatisation, but if I could first just give a bit of an overview of Alcoa's position, and then talk a little bit about privatisation, and then give you some views on the impact of the third party code, perhaps you could just direct me if I'm not answering the question.

I'm quite comfortable stating that what has happened historically between Alcoa and our position on the pipeline - I don't know if everybody understands but in the early 1980s Alcoa took a de facto equity position in the construction and financing of the DBNGP. What that actually means is that every dollar of capital that has been spent - whether it's for an Alcoa expansion or not - Alcoa has shared in those costs from day one. I think it's pretty general knowledge that the original capital construction was a billion dollars. Alcoa in those days was a 50 per cent user of the pipeline and we shared in those costs 50 per cent. It was reflected in our tariff.

I guess both privatisation and third party access are issues that are close to our heart. If I could talk about privatisation first of all, because I think unfortunately for probably everybody in the room and most of Western Australia, the two issues are very entangled. I guess I wasn't as aware of it or as involved as I am now, but privatisation saw the state government sell the asset and the initial construction - I think it's public domain information - was about a billion dollars and there was a $2.4 billion price paid. We all have an opinion on that, and that is a lot of money.

I guess throughout that privatisation process Alcoa maintained its arm's length position. We were not delighted, but we had a commercial arrangement with the government and our concerns were firstly that our rights were preserved. We are interested in two or three things: (1) that the gas continues to flow to our refineries; (2) that it's not interrupted; and (3) we had some rights to request expansions. There are obviously some rules around that. So those were the three things that Alcoa was very concerned to make sure were preserved. That's what happened, and the pipeline was sold, and the government took their money and our contract remained on foot.

Unfortunately for Alcoa, the original construction of the capital cost for construction of the pipeline was amortised over 20 years and the amortisation started in 1985. That means in 2005 the bulk of the capital will be paid off and Alcoa's tariff will drop because there is not as much capital to be repaid. Having said that, we continue to share in subsequent capital expenditure, sustaining capital and we have an obligation to fund future capital expansions as well. So the privatisation process occurred and Alcoa's reflection on the process was that our investment transferred from sovereign risk to private risk with non-recourse financing - which didn't seem such an issue at the time but has become an issue for everybody in Western Australia. That's the privatisation process, I guess.

I think the important point to take away from that is that Epic borrowed a large amount of that $2.4 billion to finance the purchase of the pipeline. Then we get into privatisation and I understand that that is what you are here today to talk about. Alcoa - I think it's an important point to make - has a small access manual contract; we are a small shipper on that but we obviously wanted to get some experience in a regulated environment and I think we're one of the first draft access manual contract holders with Epic Energy and we negotiated that contract.

We get on to deregulation and the Gas Access Regime. Our reflection on that is that (1) we have tried to maintain the high moral ground and for most of the submission period - around when the regulator was asking for submissions - Alcoa made a confidential submission, just stating their position, but we made a decision that, given that we had an exempt contract, we didn't really have a right to try and influence the process that was happening and we should sort of remain at arm's length. But what has happened is that there are a number of things that have impacted on both privatisation and deregulation.

In our submission we talk about world economic circumstances that have caused contractions in energy markets; Epic have been impacted by large borrowings and I guess it's proven hard to pay those out, or sustain their borrowings. Thirdly, the uncertainty about the access regime we believe has exacerbated Epic's financial position. The decision by the regulator has been fought in the Supreme Court - everybody in Western Australia is well aware of the process. There has been significant uncertainty; we don't believe the issues will be resolved until 2004. What that has done to Epic has made it very difficult for them to refinance. What that has done to Alcoa is that Epic have come to Alcoa and said that our contract is a significant liability and it's difficult for them to refinance.

So that is something that we would have to discuss sort of in camera, we believe. I guess the question is impact on the state - I think that was the question - from our perspective ongoing expansions to our refining operations are impacted by the fact that it is very difficult to get capacity, firstly. Secondly, the pipeline is an ageing asset and the reliability has decreased, which isn't a third party access issue. But we think the major issue is the pre-existing arrangements and the sovereign understandings of the capital investment of much more than $1 billion made by Alcoa in capital and sustaining capital. The third party access code doesn't give enough direction to the regulator, or any direction to the regulator, and we believe that there is a disconnect in recognising what has happened in the past when determining a tariff for going forward. Does that answer the question?

MR HINTON: Thank you very much for that. It's a difficult one, but another way to look at it is the counterfactual. That is, in the absence of privatisation, what commercial environment would Alcoa be in with regard to this pipeline?

MS JEFFRIES: That's a good question. We deal also with Western Power, so I would expect that it would be a similar process in that if you had a contract that was outside the regulations, which we had for many years with Western Power for similar reasons, then you would have a separate contract that had been negotiated in the past and would be renegotiated as required, but there would still be a requirement to allow third party access. So the government would own the asset possibly, but the same rules would be applied, but you wouldn't have the financial drivers that are sitting behind the problem that Epic Energy is encountering at the moment. That is my opinion.

MR HINTON: Yes, so the ownership of the pipeline is in a different negotiating position with you for your contract, regarding the availability and price of gas longer term, beyond 2005?

MS JEFFRIES: Sorry, could you - - -

MR HINTON: Is 2005 a different issue?

MS JEFFRIES: No, I think our contract is much longer term than 2005. My point is that the way the cash revenue flows to the owner is a significant asset change in 2005. The rules and the contract are still valid well beyond 2005.

MR HINTON: Yes.

DR FOLIE: I would like to ask a bit of a non-question in a way. Do you think, under this current environment, that such a contract as Alcoa had under the code regime - get away, if you like, from the minutia of Epic - that you could ever negotiate a contract like you did before? In other words, you've effectively got an evergreen contract but it doesn't appear to fit in with the pricing principles or the other areas. There is nothing wrong - but could you actually negotiate such a one in the current environment, if this was a greenfields project, with that sort of variable tariff with time horizons and then drops and - - -

MS JEFFRIES: I don't think that the code allows for that, and I see that as deficiency in the code. Alcoa's position was that the government came to Alcoa in the early 1980s because they needed a base load customer to make the whole deal come together, and I think there is a part for everybody to play in that process. But I think the third party access code is very much prospective and not reflective. So there are a lot of infrastructure assets all around Australia that require significant capital contributions from private users, who have been happy to make those contributions. If you were trying to build a pipeline today I think you would have a lot of problems getting someone like Alcoa to stump up the billion or so dollars, because there is no certainty going forward or no allowance in the access code to reflect that contribution, and I very much doubt if any of the state governments would be prepared to stump up that money by themselves.

MR HINTON: You see that negative environment being driven fundamentally by the regulatory uncertainty associated with the Gas Access Regime.

MS JEFFRIES: Which negative environment?

MR HINTON: To stump up the money for the construction of a theoretical, hypothetical pipeline.

MS JEFFRIES: That's a very big question. My view is that, reflecting on the current circumstances, I would find it very hard to present a business case to my organisation to say, "You should spend $1 billion and you will be covered by the third party access code for your commercial arrangements going forward." They would say, "Well, no, we won't invest the $1 billion. We will take our chances as a regulated shipper and pay the market rate. We won't take the commercial risk and we won't invest the - we can get a better return on our $1 billion somewhere else in our business."

MR HINTON: Let's take that a little further, Lesley, although I don't want to take you down tracks you don't want to go. That is, there are proposals around that the access regime could be improved significantly regarding greenfields investments, a hypothetical transmission pipeline for example, where there might be a holiday from access regimes, either for - 15 years some have recommended. Others, in fact earlier this morning, recommended 20 years, whereby a particular pipeline, newly constructed greenfields, would have the commercial freedom outside the application of an access regime. That sort of idea in part is driven by the sort of comment that you're making, that the regulatory uncertainty would colour significantly the commercial judgments about new investment. Do you think a greenfields concept, which has access holidays, would itself prima facie be warranted, justified or worthwhile?

MS JEFFRIES: I think I would rather not comment. I mean, it's very speculative and I guess if I was making the business case to our board I would have to - they would ask me all sorts of questions and they would query the 20-year payback. These days it probably wouldn't be good enough. I wouldn't be able to put a business case together for $1 billion with a 20-year payback. It just wouldn't be a fast enough payback for our organisation in the current economic conditions. We look for two to five-year payback on most capital projects these days.

MR HINTON: But the DPNG was amortised over 20 years.

MS JEFFRIES: That's right.

MR HINTON: But you think the environment today has significantly shifted - - -

MS JEFFRIES: I guess I would like to be very careful about being speculative, but I think commercial drivers within commodity companies have changed. The overall markets for the commodities are declining and we have to be very cost competitive and $1 billion is a lot of money. Certainly Alcoa feels that their position has been weakened perhaps by the third party access code, not strengthened, and they would be very wary of putting themselves at the discretion of the regulator or the access code or, alternatively, they would be happy to take a position and sort of make the submissions and pay for the services as a regulated shipper.

MR HINTON: Thanks for that, Lesley. Can I shift the focus slightly, because we have been talking about the hypotheticals of Alcoa investing in a pipeline; that is, as you did 20 years ago. But Alcoa is a significant, if not extensive, user of energy and if others would take a risk regarding investing in new pipeline capacity, then maybe you would welcome an access regime that gave you security of supply for your energy, eg gas in this case. Do you have perceptions to bring with regard to that sort of hypothetical once again?

MS JEFFRIES: Alcoa is very interested. The major driver is security of supply and we would take a position on that above just about everything else. In fact we would probably be prepared to pay a premium, which is what we thought historically we were doing, to ensure that the supply is there 100 per cent of the time.

DR FOLIE: They all have to be hypothetical and therefore they are not quite hypothetical answers possibly, but if we could extract - or abstract, if you like - from a part of the possible financial issues associated with the pipeline you're with, there is this issue about actually getting extra capacity. Do you think that apart from that the regime - the code as it stands now is strong enough to be able to then get extra capacity? I mean, one of the issues that flowing through your thing is that you cannot get any extra commitment out of the pipeliner. Now, part of the access regime is actually to ensure that we really do have expansions, we do have - it's difficult. There can be a time delay element due to legal things, but do you think if that was removed then the capacity core issues of the code are sufficiently strong, or do they need to be strengthened in some ways there?

MS JEFFRIES: I think that's a very good question, because I think the process for enabling you to get access on the pipeline, if you part the financial issues we're facing here in WA, are reasonably robust, fair and transparent, but I think you're right. I think the gap in the code is the time delay and at the moment I think there's a whole lot of people queuing for capacity and they are very much at the whim of the current owner being able to finance an expansion. So I think that is definitely a gap in the code but I believe, overall, the rules and the transparency, from Alcoa's perspective, are quite fair and reasonable.

DR FOLIE: But the gap can be caused by a number of - in other words, therefore, it is in the position that you can actually have delays, which is a part of the reason why the code was brought into play; that actually then could get access capacity on a more timely basis. So do you see it as an issue of timing, or do you have any ideas about variations in the code that might actually improve that general proposition? Perhaps you might like to think about it.

MS JEFFRIES: Yes, perhaps we could take that one away and make a comment in our submission.

DR FOLIE: Because I think it's quite important, the capacity issue. It's an element of access.

MS JEFFRIES: I guess our comment on that, as an exempt contract, is that we have a particular right. So we haven't looked in detail at the process to queue for capacity as an access manual shipper, but we will take that away.

DR FOLIE: One of the aspects within the code in the other areas is the notion of capacity trading. It's a slight hypothetical and may be commercially sensitive, but effectively being such a large shipper of gas and then with large process plants, which will sort of go up and down for maintenance and other such things, the possibility then comes to mind that Alcoa may be able to actually take advantage of assigning some of that gas temporarily to another party. In other words, is that done, are there any contractual areas that need to be fixed to enable you to do it, or is it in the remit of the pipeline operator to then benefit from unused gas that you might have?

MR SHAW: Maybe I'll answer that one if that's okay. Just in terms of the capacity, one of the features of having Alcoa as a customer is that we have a very stable base load, so we don't vary very much. So in terms of the capacity trading, whether it be on a day-to-day or month-to-month basis, we probably would see little benefit really for us because of the nature of our operation. In terms of the practicality of that, I guess that's best left to whatever market factors are put in place at the time. It's certainly not an area that we've been involved in.

MS JEFFRIES: Or would be looking to be involved in.

MR HINTON: I keep having questions that might have commercial sensitivity.

MS JEFFRIES: I understand.

MR HINTON: Feel free not to respond. You are very large energy user. You are a large user of electricity as well as gas, and it becomes an issue of comparisons of costs base by location and the commercial imperatives of all that. It does touch on your other comments about Western Australia, operating environment and the effects on the Western Australian economy. Are you in a position to give any comment on Alcoa's experience across different jurisdictions, given that you operate in Victoria, you operate in the west? Are there any factors, with regard to regulation, associated with the access regime that does have a regional difference or a jurisdictional difference that you could throw some light on?

MS JEFFRIES: Just by way of explanation, I look after energy in Western Australia where we spend 3 or 4 hundred million dollars. Electricity is where we are a major player on the east coast, and a different person looks after that. We believe that we'll try to draw some comparisons in our detailed submission, but I'm not really well enough briefed at the moment to comment on the east coast situation on access, particularly with respect to electricity. We're a very small gas user on the east coast.

MR HINTON: On the east coast, yes. The reason I asked the question is I think there are a lot of interesting lessons to be - insights about how the market works with a detailed case study and, unfortunately, you happen to be the detailed case study.

MS JEFFERIES: That's right, and I guess for us historically Alcoa has not been a willing participant in these sorts of forums because of the commercial sensitivity but, once again, I think we also have a moral obligation as the largest energy user in the state to make a submission but, once again, we're always curtailed and limited by the commercial sensitivity. I guess we could make a couple of comments on what we see as opportunities for improvements to the code from an arm's length perspective.

MR HINTON: Yes, please do.

MR SHAW: The first experience that we've had is the length of time and the process and obviously the longer processes run, the greater the levels of uncertainty prevail, and so in our experience so far, given all the complexity and factors involved, we've found that the process has been very lengthy and certainly a recommendation we would like to see is something put in place to ensure that these processes have a much more defined time line and each of those stages are stuck to.

One of the things we think would improve that would be clarity in terms of the definitions in the code, so we don't run into situations where they're open to legal argument and things like that that can slow the process down. We think the advantage this commission will have is that you'll be able to draw upon the experiences from around the country and certainly our hope is that you'll be able to provide greater clarity, or at least recommendations to provide greater clarity to the code.

MR HINTON: Could I follow up on that point?

MR SHAW: Yes.

MR HINTON: One of the sources of time delay is the lack of clarity, as you rightly put, but another is a number of options or scope for review or appeal process to the decision-making process that involves the regulator. The question that arises is not only bringing clarity would reduce time lines but reducing the number of appeal mechanisms would be a potential - - -

MR SHAW: Yes.

MR HINTON: Would Alcoa be supportive of that; that is, there seems to be a tension here between delivery of natural justice and the time that it takes to get an outcome either by judicial or regulatory intervention. Have you got some comments on that?

MR SHAW: Yes. I really just make the comment that we recognise it is a complex issue. There are many stakeholders involved and obviously the objectives that the regulator has which may be in conflict with a number of those stakeholders, so it's important to get the balance between having enough input into the process but, at the same time, having that sped up and, as I said before, I think the clarity will be one of the key enablers for that.

MS JEFFERIES: I think the third issue is just a process and definition in the code on sovereign understandings and pre-existing arrangements. There needs to be some definition about how they're recognised, we believe. We believe the code does not really cover off on that and we need to give some certainty. We believe - I think you sort of touched on it - people will be very shy of making capital contributions going forward. There also needs to be a process whereby potential double-dipping between parties doesn't occur with the government - perhaps might be something - or even someone like Alcoa shouldn't be able to double-dip. They don't need to be recognised twice for their capital contributions but there does need to be a process where they are recognised. The code needs to be broad enough to allow the regulator the freedom to make those decisions but prescriptive enough to make sure it doesn't occur.

MR HINTON: One aspect of the industry that you might have some knowledge of - and that's the issue of MFN clauses regarding new customers having access - most favoured customer pricing availability of gas. Some tell us that there is an emerging, if not widespread, practice in the sector that while there are foundation clients and customers for gas, new customers coming onstream are getting a certain price, but the foundation members have a clause that says whatever price the new customers get, they as foundation clients have to get at least as good. Do you have any comments you can give us on that practice - whether it's a good practice, a bad practice?

MS JEFFERIES: I would rather we didn't comment on that. It's certainly not something that is on our horizon. We don't want any better than anybody else. I would just like to comment that for the last 20 years and, as we're speaking, currently Alcoa is certainly paying 40 per cent at least above market, and we're happy to do that - you know, as long as it is fair and equitable - but we don't want to be disadvantaged and we certainly don't want to be unfairly advantaged to the disadvantage of the rest of the community.

MR HINTON: That takes me to your second-last page. Have you got it there in front of you - the top of the second-last page. Perhaps it is my inability to understand this sentence rather than what you have written. I would welcome an elaboration of the last sentence of the top paragraph, "Up until mid-2005 this tariff is at a significant premium to that of current regulated shippers." Can you explain that? It's not clear to me what you mean there in terms of how it is impacting on Alcoa.

MS JEFFERIES: I apologise for the lack of clarity, but pretty much what Alcoa is saying - and, on reflection, maybe it's not covered off - is that up until mid-2005 we're certainly paying well above market in reflection of our capital contributions. We're paying a premium to Epic.

MR HINTON: As a customer you're paying - but you were also paying that previously to yourself as 50 per cent equity holder.

MS JEFFERIES: No, I don't - - -

MR HINTON: Up until 2005 dating from when?

MS JEFFERIES: 1985, so we're paying a 40 per cent premium to the government - or to Epic - above what the market rate is as a reflection - or in part to fund the capital borrowings for the construction and the expansion, so perhaps it is not very well worded.

MR HINTON: Michael is drawing me a diagram. It's hard to get that into the transcript.

MS JEFFERIES: That's right. Michael obviously understands.

MR HINTON: I think that's correct. That's the advantage of associate commissioners. Thank you for that. Michael?

DR FOLIE: I think I have asked enough sensitive questions, but I certainly would look forward to a submission and I think that the comments that were made - particularly on the access regime, because you clearly went through one - it would be quite important to have that; in other words, the cause of the delay in things because for you it wasn't a show-stopper to negotiate it, whereas in many other companies it is but, even then, taking a long time to go through the process. I think it's quite a useful case study.

MS JEFFERIES: Okay.

MR HINTON: Thank you again for your participation today and your preliminary submission and we look forward to a follow-up down the track. Thank you.

MR SHAW: Thanks for the opportunity.

MS JEFFERIES: Thank you.

MR HINTON: Good morning, again. Let's move to the last session of our hearings today. I now invite Mr John Harvey and Ms Cassandra Walsh of WMC Resources to move up to the microphone, please. Thank you very much for your attendance today. It's appreciated. It's very important for the Commission's processes to have participation of the likes of WMC Resources, so thank you for that. Also, thank you very much for your draft written submission, which I know is well down the track for finalisation, which is a plus - thank you. We appreciate the time that it has taken between our issues paper to public hearing - it was very tight - and therefore put pressure on a number of companies and interested parties as to finalising a submission in time for a public appearance at a public inquiry. We thank you for your flexibility in producing a draft in a timely fashion.

For the purposes of the transcript I'd be very grateful if you could say who you are and where you are from, so that the microphones are working properly and that we can record that information. But by way of introduction I should also say that informality is the key. It is on record, transcript, but it is an informal public hearing process. You're not obliged to take an oath but in fact we do, though, expect honesty naturally. You are welcome to comment on other people's submissions as well; don't feel constrained just by your submission. After you identify yourselves, though, I'd invite you to make an introductory statement if you would so like, to get proceedings under way.

MR HARVEY: All right.

MR HINTON: Thanks very much, John.

MR HARVEY: Thanks, Tony. My name is John Harvey and I'm WMC's manager, energy supply. I'm an electrical engineer by profession and I've been working in the mining and power generation field for 25 years - seems a long time. Cassandra is our corporate lawyer and Cassandra has been working on Ofgar submissions, NCC submissions and now this, and has done quite a lot of work on gas access regimes.

What I'd like to start with is really to just go through an overview of our presentation, or our submission, and then I'd like to just concentrate on the main recommendations. Firstly, we have quite a background in gas pipelines - then we'll go through the objects of the code, some process issues and competitive markets and the benefits, as we see them, of the access regime and then our recommendations.

Firstly, WMC's background in gas pipelines: we were joint venturers, or part-owners of the Goldfields gas pipeline. We were 62 per cent owners and that was quite an interesting project. It started with the state agreement, went through feasibility and project financing and then from construction to operation over a time span of a good three or four years. In fact, the heads of agreement for the Goldfields

Gas Transmission joint venture was signed off in May 93 and then the state agreement was March 94. It was September 96 before final commissioning, so it was quite a long and involved process.

We certainly have a fair bit of experience there and similarly that helped develop the East Bar gas field of which we were 30 per cent owners at the time. We are also a large user of the Carpentaria pipeline for our Queensland fertiliser operations, with some 25 to 30 terajoules a day, so quite a significant load there. We are considering the use of gas for our Olympic Dam operation, which really could put us back in the field of pipeline owners again. That is just our background.

Going on to the objects of the code: our view is that the code should promote an economically efficient use and investment in gas pipelines, and certainly it should be even-handed from the perspective of both shippers and owners. We recommend an overarching objects clause and we also believe there are some ambiguities between the access law and the code at the moment and some of that has resulted in - or having to be referred to the Supreme Court, as a result.

One of the main issues that we see are delays in the process. Certainly there are examples of that with two major pipelines over here, the Dampier-Bunbury and the Goldfields pipeline. Also, there have been some delays in the Moomba to Sydney revocation application, and these simply lead to uncertainties. We see there are issues with the time frames in the code, where the regulator can extend over and over again, and then there is court action which also has led to delays. We actually believe there are incentives for service providers to delay, and we would prefer to see that incentive removed. We think if the decisions were backdated to a prescribed date, and the regulator was limited to - or his ability to extend was limited - that's our recommendation to overcome that.

Still on process issues, we see a need for accountability and transparency with the regulator and it would seem there is a lot of transparency in terms of submissions to the regulator, but then how the regulator arrives at his decision doesn't seem quite so transparent. Really, we believe that is required if there is to be a satisfactory right of appeal. We're quite happy with the rights of review. Do you want to talk through that; the judicial and the merits rights of review?

MS WALSH: I think only just to say that section 38 and section 39, as they read at the moment, we tend to agree with. We agree that there should be a merits review of decisions, but that it needs to be limited somewhat and the interaction of those two clauses seems to provide enough grounds to review to ensure that the interested parties' interests are protected.

MR HARVEY: Probably the core of the issue is developing a competitive market and we go on to define let's say the three parties: clearly the first party is the service provider, the second party is generally the foundation shippers and, in general, they are required in order for the pipeline investment to proceed and then, of course, the access regime is generally directed at third parties, who are late entrants. We also introduce another term, evergreen contracts, which is really just a recognition of the fact that perhaps people want to have an ongoing access regime but not necessarily with the terms fixed for the full length. I'll go into that one in a bit more detail later.

In terms of the benchmark tariff, we believe the benchmark tariff should be set at the third party contract level. At present it would seem that it is set more along the lines of what the foundation shipper could negotiate. Then the third parties come in after the event and tend to get the same terms and conditions which makes it very difficult for both the foundation shippers and the service provider, because there's very little room to negotiate. Our recommendation is that the benchmark tariff should be set - what we're calling a vanilla option - on the basis of short-term contract, low volume - and that's what a genuine third party is, or normally what a third party is. That will leave room for negotiation for a larger user that might bring a longer-term contract, better security - both financial and security of supply - and perhaps higher volumes. The other thing we would fully support is capacity trading.

In terms of benefits of the access regime, we see significant benefits upstream. Clearly, to go back to first principles, the access regime would be substituting - the whole idea is that it substitutes for a competitive market and in order to avoid monopoly rents. It really assists with arbitrage and integration of the whole gas and energy market. Whilst you could argue that the code hasn't really been effective in Western Australia as yet, there certainly have been some regimes in place, and you can see the benefits in the upstream gas market benefits. In our submission there is actually a table that shows the wellhead price of gas. You can see it has been coming down considerably in the last five or so years.

The next issue is incentives for investment. We can see no evidence where the gas access regimes have adversely affected investment. We believe downstream markets have been encouraged by access regimes. One thing that we think could be a problem is that sometimes you have a situation where a third party is wanting - he's seeking access and there is a temptation on behalf of the service provider to offer the access on the prevailing tariffs, plus any incremental costs. For instance, if a third party comes in and it means there is a need for a compressor station, then sometimes the service provider might think, "Well, he needs to contribute to that compressor station."

In our view that's double-dipping because the whole access regime should in fact take that into account, so that the capital costs would be divided evenly and the differences between one party's service contract and another's would be more to do with what they brought to the table in terms of length of contract, size of the contract, financial security and those sort of things, rather than the fact that they just happened to be the ones that came up just before a compressor station was required.

In terms of coverage, we recommend no changes to the coverage criteria under the NCC. We do note that the NCC, for instance, recommended no revocation for the Moomba to Sydney pipeline and that recommendation was made in November last year and there is still no decision from the minister, which is a frustrating thing. Time delays are frustrating for everyone. Having been through the process, we find that just adds to the frustration.

In summary, we believe we have experience on both sides of the fence, so we do have something to bring to the table. We certainly have some issues with the delays, some process issues. We can see a competitive market is being developed through the access regime and we certainly see benefits in the access regime. We think there are adequate incentives for investment.

Just before we finish this bit and hand over to questions, I'd just like to reiterate the main recommendations we make. The first one is process delays, backdating of decisions and limitations on extension of time. The next one would be third party benchmarks instead of the present regime where we really have benchmarks that are set on similar terms to foundation customers and that would encourage negotiated contracts, which we believe is a good outcome.

And then two more recommendations: the evergreen contracts, which I touched on previously, and the idea of the evergreen contract is the access entitlement endures but the terms are the prevailing terms, so you book capacity and you pay whatever the prevailing terms are, but you have some flexibility there because I think it's quite difficult for everyone, but certainly for third parties, to forecast what their needs might be in 10 years or 12 years time, but you do need some certainty of energy supply, so an evergreen contract, which would allow you to say, "Yes, we book capacity but we have some flexibility there, but we pay the prevailing terms," we think would really add certainty on both sides of the fence.

Finally, capacity trading: we do believe we need some mechanisms to encourage capacity trading because certainly, if you have a long-term contract, there are quite often times where you've over-contracted, and you've had to contract for a long period, and capacity trading is one way to mitigate your costs there. So I guess in conclusion we do see benefits with the access regime. We do think there are some adjustments that are required but we fully support the principles.

MR HINTON: Thanks very much, John and Cassandra. Taking into account what you're recommending in terms of changes, that really reinforces the point you've just made again in conclusion, that from WMC Resources' perspective, not only is the access regime warranted, it's not all that different to that which you think is appropriate, which is quite varied with what we've heard from a number of other players in the sector.

So what I'd like to do is explore with you your main areas of interest that you've flagged this morning, and that in particular first of all includes this delayed decision-making coming out of the regulatory intervention that's occurring. I'm perhaps a little unclear as to how backdating decisions is going to address delays in all cases. I can see how it might relate to a decision in terms of the cost of the gas that someone is seeking to get because then the commercial imperative to delay is neutral. The decision is a decision that's backdated to the time of application.

But the regime seems to operate much more widely than just a question of pricing. It touches on all sorts of questions of access in coverage, revocation, and many of the delays are associated with those other activities of the access or the implications of the access regime. I'm wondering whether you've had some thoughts on that aspect of the regime.

MR HARVEY: Certainly there are those two aspects. There's the commercial and, as you've touched on the commercial aspects, backdating can readily solve that. But I do think there is a link between available capacity and the commercial terms, and if both parties can be satisfied that there will be an outcome, and maybe we don't know what the outcome is but there will be an outcome that will resolve those commercial terms, then the right to access may well be resolved anyway.

For instance, a service provider has to make decisions on whether to expand the pipeline through either an additional compressor or looping, and in general he would have the incentive to have increased capacity through his pipeline, so I don't see that there would be an issue with the service provider saying, "No, I don't want a new user on my pipeline." Providing he believes it will be on fair commercial terms, then I believe they could proceed with let's say the technical or the upgrade works that are required, and both parties could agree on access subject to the terms which would resolve in due course.

MR HINTON: Well, a related cause of delay of concern relates to the lack of clarity within the access regime, with potential for tensions in the objectives or tensions in the parameters being looked at, or that the regulator is required to look at, that leads to regulatory uncertainty, that leads to a perception that there are grounds for appeal and therefore there is a direct source of uncertainty that in itself underpins a process of appeal or review, and that particular set of characteristics can be a very important force for delayed outcomes. You've got an objects clause but do you think there are other areas of the access regime that also could be tidied up or improved that would help address your basic concerns of delay in regulatory outcome?

MR HARVEY: Yes, I think so. It seems to us there are ambiguities in the code, and when you look at the code, one of the issues in the Epic case here was whether the regulator should select an initial capital base between DAC and DORC, and initially he did that, and the court directed - well, you don't need to be restricted between those two values, so in fact he ended up with an ICB above that range. It's quite ambiguous in the code. There are a lot of things in the code that are not quite so clear.

There are a variety of ways in which the regulator can arrive at the cost of service and the revenue stream, so I guess we would see probably a slightly more prescriptive code in terms of arriving at what we're calling our benchmark tariff or vanilla type tariff, and then allow commercial forces to negotiate from there, whereas at the moment the code is ambiguous and subject to interpretation that is not quite clear. So we'd prefer those ambiguities were removed. Do you want to add to that, Cassandra?

MS WALSH: No, thanks.

MR HINTON: One view that's been put to us is that if you've got a regulator's decision subject to review beyond say a judicial process of natural justice or denial of natural justice, such that they become merit based, you're getting a review process that's second guessing a regulator that in itself is encouraging delays, encouraging delays in regulatory outcome. Would you be comfortable with a system that reduced the scope for merit-based review? I had in mind, Cassandra, that you've referred to sections 38 and 39 looking pretty good, and I was really seeking elaboration of that.

MS WALSH: I think that there has to be some review that goes beyond the normal principles of administrative law and natural justice, and I guess that's a flow-on effect from the uncertainties that lie in the code at the moment. I think - and, John, you might correct me if I'm wrong here - if there was more definition about the process that the regulator needs to take, and less ambiguities in the factors that he needs to take into consideration, then arguably those rights of review could probably be narrowed even more, but when you've got an ill-defined manner in which the regulator applies the code, then I think until that's resolved you do need some form of merits-based review.

So they really go hand in hand, if that makes any sense, so I can't categorically state that yes, we'd be happy with no merits review, because arguably if there was more definition in those provisions of the code that deal with the regulator making his decision, then it probably wouldn't be as necessary as it is at the moment, and we accept the fact that it does cause considerable delay and it's something that needs to be taken into account.

MR HINTON: So if the parameters that the regulator was examining were clearer, such that the regulatory outcome was much clearer to the parties ex ante, then the need for a merit review would be reduced?

MS WALSH: I think so, yes.

MR HINTON: It's a challenge for the drafters.

MS WALSH: Exactly.

MR HINTON: We welcome your input on that one, too. I'd like to move on to coverage and I want to explore with you your thinking as to why you think the coverage is about right. Well, let's even go further than that - you're more categorical. No changes are required to the coverage criteria. In particular I want to explore with you whether you're comfortable with the fact that coverage criteria is very much a switch process. It's either on or off. You're either covered or you're not, and if you're not covered, fine. If you are covered, then you're subject to the regulatory regime associated with the access regime and all the forces of that. Some see that as very black and white and not necessarily sufficiently flexible to handle the divergence of characteristics of the sector, so I'd welcome your elaboration on how you've reached a conclusion that no changes are required to the coverage criteria.

MR HARVEY: I guess I'd like to hand this over to Cassandra in a minute but, as an overview, we see the need for coverage as really a substitute for competition, but competition is the ideal way to go and you could argue that it's a poor substitute but it's the best we can do. The whole principle of the coverage is if there is adequate competition, whether it's direct, gas on gas, or upstream or downstream - if there's adequate competition then you revoke the coverage.

So in terms of the coverage criteria, we think that's adequately covered. You could go into detail on the way that that is interpreted. For instance, you do get cases where you get two pipelines in parallel and that's deemed adequate competition so coverage has been revoked. Now, it depends on the circumstances. There may not be adequate competition but we think the principles are in fact correct. Cassandra, would you like to add to that?

MS WALSH: Not really. There's obviously been a considerable amount of case law discussing the coverage criteria, and competition also in light of Part IIIA of the Trade Practices Act, but I think the criteria as they stand alone meet the objectives that we believe are the objectives of the code, which is to encourage competition. So, no, I think that they're fine as they stand. We'll always get into a bit of toing and froing about the precise meaning of them and their application, and maybe that's a separate issue, rather than the criteria themselves.

MR HINTON: Yes, but if the parameter for coverage is essentially the existence of market power, prima facie you could argue that market power is not a black and white issue, it's one of degree, and those circumstances that had absolute market power might warrant much heavier-handed intervention than a case where market power is significant or substantial but more than material, for example, such that the intervention in that second case might need to be much lighter-handed, and that's why I was seeking to explore with you why you were comfortable with the switch approach of either covered or not covered, when in fact you might have a case for having coverage but have different sort of intervention that flows from that coverage decision.

MR HARVEY: I guess we understand that. We're probably getting a bit pragmatic about it inasmuch as there's a lot of uncertainty already and if you have this situation where you're partially covered or maybe you should be covered unless except under certain conditions, we think that just would add more confusion, which we've already seen with the way the code is written at the moment.

MR HINTON: In a number of places in your submission you make the point that WMC Resources wishes to always be able to maintain the rights to build its own pipeline if necessary. Is this more or less just a statement or do you view that the code needs to be rectified more, or is there anything in the code that would ever preclude you from building your own pipeline?

MR HARVEY: No, I guess we're making the point that we see ourselves more than just a large shipper. We think we will be a pipeline owner in the future. It's a matter of whether we are a long-term pipeline owner. We are not really making a commentary on whether the code is stopping the construction of a pipeline. Not at all.

DR FOLIE: And if you build a pipeline you don't mind if you are covered or uncovered? In other words, you would then be subjected to the code.

MR HARVEY: Certainly. Not at all. In fact if we build a pipeline and there are other users that can use that pipeline, then generically we would be better off if they do use it because they would be sharing the cost of capital. So we would encourage that.

DR FOLIE: I'd like to ask you a little bit about capacity trading.

MR HARVEY: Okay.

DR FOLIE: I think everybody talks a little bit about it and says we need to have more of it. Do you have any ideas about, in practice, how it might operate? In other words, who would be the manager of the capacity trading regime?

MR HARVEY: It's a really good question. Let's just go back a step. There are normally a number of shippers, quite often foundation shippers, which have contracted capacity that is unutilised. And you even get the bizarre situation where the shipper feels he has no surplus capacity yet he knows, on a day-to-day basis and even on a month-to-month and year-to-year basis, that part of that contracted capacity will not be used. So does the shipper elect to sell that capacity again, but run the risk that he is double-sold? Sorry, does the service provider do that or does the shipper try and then sell the capacity to someone else?

At the moment it really is virtually a bilateral arrangement where, if you can find someone else that is interested in that capacity, then you can sell it. If there was an open market for it then we think that would be better for all concerned. Certainly more efficient. How that market works and who supervises it is quite difficult. I believe the service provider would be the best place to run that market. Now, clearly he would need an incentive to do it and it would be regulated much the same as a normal access regime. It probably isn't so vital who runs the market as long as the capacity trading market is run on a basis that is open and honest to all.

DR FOLIE: Is there an issue? Or what is the practice in terms of as a shipper, if you have a contract? Are the current contracts framed such that then you have rights to capacity trading or are those rights - which appears to come through in your submission - retained by the pipeline owner in the sense that you talk about double-selling capacity and things like this?

MR HARVEY: I guess I don't want to go into the terms of our contracts.

DR FOLIE: No, not your contract but your custom and practice.

MR HARVEY: I think, in general terms, people are able to trade unutilised capacity. It's really just a matter of matching needs and remembering you have different categories. You have people that have surplus capacity for a long time and then you have people who have an outage or a shutdown, a planned shutdown, and they may have a month where they have capacity they are paying for and someone may be able to use it. But in general you are able to trade your capacity but it's not an honest market like the open-outcry market, it's one where you have to find someone who is interested and their needs fit yours. Quite often I think opportunities are lost because you are not sure who is available and who would be interested in the capacity.

DR FOLIE: As part of that - those access regimes - is that caught up within part of the code because a part of the access arrangement is then - it's the obligation of the pipeline owner to ensure that you do get access; so he doesn't actually prevent access because you are peaking and other such things.

MR HARVEY: Sure.

DR FOLIE: You use that as a commercial negotiating area. Does this ability to be able to then, between the shippers, trade - does that come under the regulatory purvey or can you actually then do that after you've got your broad access arrangements?

MR HARVEY: Either is acceptable. I think certainly my own preference would be that you have an access arrangement, or let's say some terms or rules for capacity trading, and then people do their best to deal within it. For instance, if you sell some capacity and then you have a peak and you go over it, then you either have to have an authorised over-run or you pay a penalty for unauthorised, or you are unable to deliver to your customer. In other words, buyer and seller beware.

DR FOLIE: So part of a pipeline operator access regime would be to have some clear rules about capacity trading, which I think by the nature of your submission you are saying isn't really the normal custom and practice in the industry.

MR HARVEY: Yes. We have elected not to go into detail on that but we do think it would be worthwhile to have some clear guidelines for capacity trading.

DR FOLIE: And done outside the code or then registered within the code?

MR HARVEY: I think inside the code. Certainly done inside an agreed framework, preferably within the code.

MR HINTON: John, let's get back to your pricing or tariff comments. Your executive summary has I(3)(h). The reference tariff - and you've referred to this a couple of times:

> The reference tariff should be set as a third party access tariff with clearly defined parameters and should be set consistent with the overriding objective of achieving investment in and utilisation of the relevant pipeline.

The reason why I come back to this and revisit it is to look at how that could operate on a day-to-day basis, particularly in circumstances of first of all foundation customers that have certain longer-term interests and considerations, including even the possibility of paying a premium to fund capital contributions to set up the transmission pipeline or, secondly, there may be in existence MFN arrangements that clearly colour the environment for flexibility of how you might price for new customers and old customers, and I can't quite see how your description of this third party access tariff concept fits in with those sorts of realities of the sector. How does it work? What would be the outcome?

MR HARVEY: I'm not sure.

MR HINTON: Who gets the higher price and who gets the same price?

MR HARVEY: I'm not sure I quite understand your point. If I can put it into a scenario, I guess what we are saying is that we have a foundation shipper and let's say he has got preferential tariff arrangements. Then you have a third party who comes along and doesn't necessarily have that preferential arrangement because of lower volume and shorter term, et cetera. I'm not sure where the inconsistency lies. Could you reiterate?

MR HINTON: The foundation customer might in fact be paying a very high price because that's part of the amortisation of the costs of constructing the transmission pipeline. They haven't contributed any capital but they are funding it through a higher price. So they don't have a volume discount; they in fact have a premium cost to the gas.

MR HARVEY: Yes. I guess the way we would see that working is that the foundation shipper would enjoy the rights of the prevailing tariff, if it were lower than what he first negotiated.

MR HINTON: So MFN would operate, come into play. So if a third party customer comes on board and gets a non-premium price - gets a discounted price to the foundation customer - then the foundation customer would then get that price too.

MR HARVEY: Yes. It's a dynamic situation. In general, as the amount of load or gas flow increases, in general the tariffs will decline, and clearly the converse is true. So if you haven't got a rapidly escalating throughput in the pipeline, in fact the foundation shipper would probably normally have a lower tariff than a third party. But if you have a case where the throughput is increasing rapidly, then that could turn around. The way that that can be resolved, as I say, is that the foundation shipper either gets the benefit of the prevailing tariff if it's lower or even perhaps a discount to the prevailing tariff.

MR HINTON: And that would need to be made clear in the parameters to be taken into account by the regulator.

MR HARVEY: Yes. I think the principle is that if you are bringing to the table long-term high-volume high security, then you deserve a volume discount.

DR FOLIE: What I'm hearing you saying is that - we heard just before from Alcoa, who then sort of discussed the nature of how they signed up originally, which of course was in 1984 which was a totally different era. What you are really saying is that that style of contract is unlikely under this new access regime. They were protecting a certain set of rights and they need a certain contract profile.

You are now saying that under access and the new rules within the pipelines, that effectively that template of a contract is unlikely; one never knows what emerges into this new era and you would expect foundation customers to then participate because they are guaranteed access and a whole lot of rights now through the code whereas before it had to be privately negotiated and often with the government.

MR HARVEY: Yes. Quite right. At all times we are talking about efficient use of capital. So the service provider requires protection as well to make sure he is getting an adequate rate of return and can cover all of his costs. I just don't think it's fair and equitable if a Johnny-come-lately gets a lower tariff and that tariff in fact is lower by virtue of the fact that the foundation shippers and the service provider were there up-front many years ago.

DR FOLIE: So in most of the agreements - and you've pointed out you're a partner in a lot of pipelines - something like an MFN clause, because you use them in a foundation in most of those, that it's now becoming the custom and practice in Australia of the year 2000 and beyond.

MR HARVEY: Yes.

MR HINTON: I'd like to also come back to another one of your executive summary points. That is, I(3)(k). It says:

> There should be separation between the person making the decision about whether or not a pipeline should be subject to the regime - that is, a coverage issue -

the switch we talked about before -

> and the persons who make the decision about the regulatory arrangements once a pipeline is subject to coverage.

And you say that you would not support the two decisions being made by the same body. Can you elaborate on why you would be concerned about the same body making those decisions?

MR HARVEY: It's really just a conflict of interest issue I guess. What we really say is that the regulator applies the rules. It doesn't really mean the regulator makes the rules. We just think that this is a situation where the two should be separated so that there is no conflict between whether it's subject to coverage or not.

MR HINTON: You think there's a risk that the entity making the decision on the application of the rules could in fact encourage a decision to apply the rules - that is, put them into coverage - because you are going to be making a decision about the coverage. Is that the intention?

MR HARVEY: We think a coverage decision needs someone to step back a yard and see what's really happening and I think that's awkward for the regulator to do that. I guess that's the main point. That's right? Is there anything you want to add?

MS WALSH: Yes, I think so, particularly given that often the applications to have coverage revoked are actually commenced after the regulator's determination and assessment of the access arrangements has commenced as well. We think that, particularly in those circumstances, having totally distinct bodies making that decision doesn't allow the lines to become blurred, so to speak.

MR HINTON: But if you had alignment of objectives and the parameters to be taken into account I would have thought that coverage and application are linked dramatically. You are seeking to achieve an objective and you are applying parameters to deliver that objective. The prior question is whether or not you should be applying those parameters to achieve that objective. The linkage is very fundamental, I would have thought; coverage and application.

MR HARVEY: Yes. I guess if I could use an analogy, it's a bit like the football umpire making a report. Who should be on the tribunal? Should it be the umpire or should it be someone else? We feel that the regulator is quite close to the action and it should be the tribunal chairman and not the umpire who decides.

MR HINTON: Isn't that a review clause rather than a coverage clause, though?

MR HARVEY: Well, yes, it is, but in terms of - isn't coverage a review clause, anyway - the way I see it?

MR HINTON: I thought coverage was almost a prior question.

MR HARVEY: You can say that, but in fact it comes around the other way. Most applications are applications for revocation, so you're already covered. The regulator is already dealing with that service provider, and then there's a question - - -

MS WALSH: I think that gets back to the point I was making before - that in a perfect world it would be great to see applications to have coverage revoked made prior to the submission of any proposed access arrangement but, in reality, that doesn't appear to be what has happened and what is happening, so using your one body scenario, you'll have a regulator that would have received a proposed access arrangement and started down the path of considering that proposed access arrangement, calling for submissions from interested parties, et cetera. Then sometime after the commencement of that process an application might be made to have the pipeline coverage revoked and then you've effectively got that one body looking at the two issues. We're concerned that, given that set of circumstances, one body wouldn't be able to actually draw the line, separate the issues adequately and so determine on an impartial basis where coverage should actually be revoked or be maintained.

MR HINTON: So you are particularly putting weight on the revocation decision rather than the prior question of coverage as if nothing had happened beforehand.

MS WALSH: Yes.

MR HINTON: I understand the point you are making now: distribution and transmission. You have focused particularly on transmission. You don't want to comment on distribution perhaps?

MR HARVEY: No. We don't have a lot of experience in the distribution, so we haven't commented.

MR HINTON: Then let's move on to greenfields.

MR HARVEY: Okay.

MR HINTON: The ACCC draft preliminary guidelines on greenfields, such as access holiday – also Parer report reference to 15-year access holiday. I'd welcome your comments on two aspects: is the regime flexible enough to establish a proper environment for greenfield investment? If not, do you think that the greenfields proposals that are floating around have validity? We would welcome your comments on this broad issue regarding the investment.

MR HARVEY: I think what we would like to do is consider that and get back to you. It seems to us that a lot of the problems we have had are really teething issues and there has been a lot of discussion - and even court decisions - based around an initial capital base. In the case of a greenfields, if the code is in place and then the greenfield pipeline commences, there should be no debate on what the initial capital base is, so I think that takes away a lot of uncertainty. Certainly our initial view is that we really can't see that there are any issues with the code applying to greenfields as it does to brownfields, but I think we'd like to get back to you in more detail on that.

MR HINTON: Thanks, John. I am about run out, Michael.

DR FOLIE: I'm run out, too.

MR HINTON: Is there anything you think we have neglected that we should have given sharper focus to that you would like us to explore or you would like to comment on?

MR HARVEY: No, I don't think so.

MR HINTON: Thank you again for your draft. We look forward to finalisation and any further follow-up that you might be making in terms of submission. Thanks again also for your participation today - it's appreciated - and thank you for bringing WMC Resources perceptions to the issues.

MR HARVEY: Thank you very much.

MS WALSH: Thank you.

MR HINTON: That does conclude today's hearings. We will be starting again tomorrow morning here at this location in Perth but, before we close off for today, I would like to invite anyone from the floor who would like to appear at the public hearing today to identify themselves. You are most welcome to. The system is that if you would like to you come up to the table and take a chair in front of a microphone and say who you are and who you represent, you will then be free to make a statement to the Commission and we would be pleased to ask you questions if we wished. Anyone from the floor wish to speak at this stage? Fine. I will therefore adjourn these proceedings and the Commission will resume tomorrow at 9 am in this location. Thanks to everyone for attending.

AT 12.26 PM THE INQUIRY WAS ADJOURNED UNTIL
TUESDAY, 2 SEPTEMBER 2003