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TRANSCRIPT OF PROCEEDINGS

PRODUCTIVITY COMMISSION

DRAFT REPORT INTO GAS ACCESS REGIME

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

TRANSCRIPT OF PROCEEDINGS

AT PERTH ON THURSDAY, 1 APRIL 2004, AT 9.04 AM

Continued from 31/3/04 in Adelaide

MR HINTON: Good morning and welcome to these public hearings here in Perth for the Productivity Commission's review of the Gas Access Regime. My name is Tony Hinton and I am the Presiding Commissioner for this inquiry. My fellow Associate Commissioner on my right is Dr Michael Folie.

The inquiry terms of reference were received from the Treasurer in June 2003 and cover, in brief terms, the following six matters: firstly, benefits, costs and effects of the Gas Access Regime, including 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 decision-making arrangements under the Gas Access Regime; sixthly, the appropriateness of including in the Gas Code minimum requirements for access to users, both price and non-price requirements.

The Commission is grateful to the various organisations and individuals who have already participated in the initial round of hearings last September and through earlier submissions. This round of hearings follows the release by the Commission of our draft report last December and the purpose of these hearings is to provide an opportunity for industry parties to discuss their submissions commenting on that draft report. Participants are, of course, also welcome to comment on the views expressed in other submissions. Hearings have already been held in this round in Melbourne, Brisbane, Sydney and Adelaide. The final report will be submitted to the government in mid-June, as scheduled.

We like to conduct all hearings in a reasonably informal manner, but I remind participants that a full transcript is being taken. For this reason, comments from the floor cannot be taken during proceedings, but at the end of the day I will provide an opportunity for anyone who wishes to do so to make a brief presentation. Participants are not required to take an oath, but are required under the Productivity Commission Act to be truthful in their remarks. 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 Commission staff here today. Submissions with regard to this inquiry are also available on the Commission's web site.

To comply with requirements in the Australian government occupational health and safety legislation, I note for all attendees that this building operates a standard alert and emergency evacuation procedure. Fire exits are through the door at the rear of the room and out to the right onto the terrace.

I would now like to welcome our first presenters for this hearing here in Perth, Mr David Williams and Mr Anthony Cribb from Epic Energy. I invite you to get proceedings under way with an opening statement or introductory statement. Thank you very much.

MR WILLIAMS: Thank you very much for providing Epic Energy with the opportunity to participate in today's hearings. As the Commission is aware, we have already provided a submission on a number of particular aspects, although largely you will see the theme of our submission draws largely, or relies pretty heavily, on the industry association, the Australian Pipeline Industry Association, as far as more general comments are concerned.

I'd like to make a few introductory remarks and then Anthony will go into a more detailed commentary on some of the points that we have raised, in particular, and then we would be happy to answer any questions of the Commission in relation to matters raised in our submission or otherwise. To the extent that we can answer those in a public manner, we will. To the extent that we would not be able to answer those in a public manner, we would be happy to deal with that on a confidential basis at a subsequent time.

The particular circumstances confronting Epic Energy at the moment have made balancing the pressures of sales processes and the demands of normal business a challenge, to say the least. However, we acknowledge the importance of having key industry stakeholders participate in the process to ensure that there is public confidence in the recommendations that the Commission makes in its report. Epic Energy has aimed to do this despite those distractions.

Today we intend to provide an overview of the key points from our submission recently provided to the Commission. As I mentioned, we would be happy to answer any specific questions from you following this overview. Before doing this, however, there are some preliminary points we would like to make. First, the Commission's draft report acknowledges that the Gas Access Regime has the potential to distort investment incentives and that there is a need to move to more light-handed regulation. The ACCC's submission in response to the draft report appears to argue otherwise, arguing that the regime has seen overwhelming benefits.

The present circumstances confronting Epic Energy are direct evidence supporting the Commission's draft finding. In fact, it could be readily said that they go one step further - that investments are being distorted because of the code and the application of the code. The recent power issues in Western Australia are a direct result of this. Accordingly, we urge the Commission to not remove that finding in the final report. This is particularly important given that the gas industry is regarded as an emerging industry, not a mature industry.

Gas should be an important part of the fill mix choice in the 21st century for environmental and security of supply reasons. Current growth forecasts show that there is a need for further infrastructure to not only meet the expected demand but also to create an integrated infrastructure network that will create the impetus for competition in the energy industry. The need for investments, however, should not be limited to new infrastructure. A lot of the emphasis we have seen in the public arena and public commentary has focused purely on new infrastructure and the need to provide an environment that will encourage investment in new infrastructure.

The need to ensure that existing infrastructure is maintained and enhanced is just as critical, if not more so. However, Epic Energy considers that the current regime has allowed regulators to apply their view of economic efficiency - and I particularly use those words "economic efficiency" because they are fundamental words that are adopted in some of the recommendations of the Commission - which equals lowest cost outcomes in the regulatory approval processes. The regime must be altered to remove such outcomes, otherwise there is a serious risk that the safety and integrity of existing infrastructure will be severely compromised.

There is a growing list of examples of the dangers of allowing regulators to focus on lowest cost outcomes; most recently as this week in a report prepared in connection with the Ontario electricity transmission system. That report has shown that the integrity of that system is in dire straits because of the lack of investment, caused primarily by the fact that prices have not increased for more than 10 years. The lowest cost outcome focus has directly caused costs to be cut in the key areas of safety and maintenance.

I'll interpose here to say that, as far as Epic Energy is concerned, safety remains our number one priority - always has been, always will be - but you've only got so much money in the pot that you can deal with that. You will, therefore, reserve that money to deal with the urgent issues to ensure safety. While that will certainly have regard to the short-term issues, what you need to watch out for is if there is not sufficient incentive to invest in the existing pipeline infrastructure you will have an impact on the longevity or the long-term aspects of the supply, integrity and efficiency of that system. It's something that you won't know about today, but will come and hit you down the track when you least expect it.

We have now seen this - when I talk about "this", that is that lowest cost outcome focus - in many jurisdictions, in many industries and in many countries, such as in Europe and the United States of America and Canada. The inconvenience to the public and the risk to human safety is evident with blackouts and, in some cases, unsafe infrastructures. We must learn from these mistakes. This requires action to be taken now, because the fix cannot happen overnight.

While Epic Energy endorses the intent of the Commission's draft report to (a) move to a more light-handed regime, (b) ensure that the regime does not act as a disincentive to investment and (c) better specify the regime, Epic Energy is concerned to ensure that the original intent of the national competition policy reforms is not undermined. This is particularly important given that any recommendations made by the Commission will have to undergo a deliberative process with the Ministerial Council on Energy before any changes will occur to the Gas Access Regime. Accordingly, Epic Energy's focus in its submission has been to ensure that the final recommendations and any changes made to the Gas Access Regime are not inconsistent with that original intent, as expressed in the Hilmer report, and the intergovernmental agreement on access to natural gas pipelines, the 1997 agreement.

The need to maintain this consistency has been reinforced in recent decisions from the Australian Competition Tribunal on the Moomba-Adelaide pipeline system and the GasNet transmission system in Victoria. These decisions provide important guidance to the Commission. The most important conclusions from these decisions are as follows:

> It is not the task of the regulator to determine values for parameters of an access arrangement which it thinks are consistent with the code. Rather, its role is to assess whether the values proposed by the service provider are consistent with the code and fall within a range of values that are reasonable. The regulatory approval process for assessing an access arrangement is, by its very nature, a high-level planning exercise that will derive values for key parameters that cannot be quantified with any sufficient degree of certainty.
>
> As a result, it is a highly risky commercial action to take the lowest figure found in any such exercise. It exposes the service provider to an asymmetric risk, whereby the likelihood of underestimating the true actual value of particular parameters is much greater than the risk of serious commercial understatement of the expected value. Regulators of transmission pipelines have, however, been acting unreasonably in all the circumstances by misapplying their statutory function, falling beyond the boundaries of what a prudent commercial operator would be expected to do, thus adversely affecting a service provider's legitimate business interests.

If I might again interpose in there, one of the areas of concern to myself particularly, and to Epic Energy as a whole, was the changing - and with good intent - of the approach under the code to a simple statement of policy and then removing

some of the factors - some of the key and very important factors - not the least of which was a direction to the regulator to take into account and to balance the public interest. At the end of the day, gas transmission pipelines are an important infrastructure in Australia, servicing the public of Australia, and what could be more important in that than balancing the public interest, which may not come out of an objective referring to promoting the economically efficient use of and economically efficient investment in services of gas transmission pipelines.

As I've mentioned - and Anthony will talk more about it - there has been real concern in the use of the term and the interpretation of the term "economically efficient", when at the end of the day we're seeking to have a fair system of access to third party pipelines which, surely, must be and provide a result which is in the public interest, which is a much broader and much wider interest than "economically efficient" may be interpreted to be.

As a final introductory matter it is noted that the review of the Gas Access Regime is proceeding at the same time as significant changes are occurring in the ownership of Australian gas pipeline businesses. A major factor driving these ownership changes is inappropriate application of the current regulatory regime. In these circumstances Epic Energy urges the Commission to ensure that the recommendation of its final report is unambiguous and accompanied by clear guidelines for the implementation and subsequent application. This is particularly important, given the process, as I mentioned, outlined by the Ministerial Council on Energy that is to be followed before any changes are to be made to the Gas Access Regime.

Before I hand over to Anthony to give you a summary of the main points of our submissions, I again remind you that I sit here as the chief executive officer of a company of one of the major gas transmission pipelines in Australia that has been embroiled in a regulatory impasse since 1999, some four to five years - some five years since the pipeline was acquired - and I sit here with a pipeline, a significant piece of infrastructure in the state of Western Australia, that we have been unable to expand since 2000 because of that regulatory situation and I sit here with a pipeline of the brink of going into external administration. How can that be in the public interest of the state of Western Australia? How can it be in the public interest of the people of Australia that a significant investment, and significant investment decisions such as that, have been put in this situation by the regulatory environment as embodied by the national access code? On that point I will hand over to Anthony to give you a summary of our main points.

MR CRIBB: Thanks. Our submission, as we said before, has been made in light of the APIA submission. There are particular aspects of the APIA submission which we have not sought to replicate in our submission. Primarily they're comments in

relation to coverage. We endorse those comments and urge the Commission to provide clear guidance on the definitions of the coverage tests being proposed in the draft report, primarily in relation to the material and substantial tier 1 and tier 2 regulatory regimes.

Our submission has focused primarily on the objects clause; the importance of the section 2.24 factors. In addition we have focused on particular aspects of the access arrangement approval process. It is very much those aspects of the code which Epic Energy has had the most involvement in through its regulatory processes. We have had experience in relation to the coverage aspects when pursuing our Darwin to Moomba pipeline proposal. However, we haven't had any direct involvement as yet on an application of the coverage criteria.

First of all, the objects clause: the key point we have made in the submission is that the inclusion of the proposed overarching objects clause is a positive step forward and it's likely to enhance the effectiveness of the Gas Access Regime only if policy-makers and regulators are provided with clear guidance, once again, on how the objectives of the promotion of economic efficiency and the promotion of efficient investment are to be interpreted in the context of the national competition policy reforms. One of the key points we are making throughout our submission is that the intent of the national competition reforms should not be forgotten.

Those policy reforms made quite clear the need to protect such factors as the legitimate business interests of service providers, the interests of users and prospective users, the nature of the regime that should apply to infrastructure which met the test for declaration/coverage as part of the Hilmer reforms, so without the guidance on what is meant by the proposed overarching objectives clause tied back to those particular original intentions of national competition policy reform, we consider there is a real risk that the narrow theoretical focus of regulators which has been reflected in the application of the code to date, particularly in relation to Epic Energy's access arrangement assessment processes, will have the effect of deterring investment in gas pipeline systems and limiting the prospects for the economic development and from the promotion of competition in upstream and downstream markets, which of course are the very intent of the Hilmer competition policy reforms in the mid-1990s.

Tied in with that is a link to what the access regime was intended to be. It was intended to be a regime which ensured that parties had a guaranteed right of access to regimes. The proposal was for an arbitration model. We do have an arbitration model in the code and we urge the continuance of that arbitration model. However, we have seen the interloping of the regulatory approval process. The Competition Principles Agreement sets out very clearly specific objectives that an arbitrator must take into account. Those very objectives and factors are reflected in section 2.24 of

the code.

Those very factors and objectives must be specifically taken into account by regulators, otherwise we run a serious risk that regulators, whose decision is binding upon an arbitrator, are assessing it against a test which is different to which an arbitrator himself is assessing. That raises serious concerns about the effectiveness of the access arrangement. The requirement for balancing of the interests that we have set out in the submission is consistent with not only the Hilmer report but also the intergovernmental agreement in 1997. We accept that there is a range of objectives and factors - which courts have acknowledged are conflicting - not only the section 2.24 objectives, but also the section 8 objectives.

However we believe that the difficulty that has arisen with the application of the 2.24 factors and the regulatory approval process, which has its foundation in section 2.24 of the code, is a result more so of the misguided approach of regulators in their assessment process, as we have seen in the recent decisions of the tribunal. The role of the regulator is not one to set a tariff or to set particular values. The role of the regulator is to assess what has been put forward to determine whether the regulator's proposals fall within a reasonable range.

Clear guidance given in the final report to that effect - that the role of the regulator is one to assess whether the service provider's proposal is within the reasonable range - would overcome much of the difficulty that regulators themselves claim has resulted in the application of the code as it is currently structured to date. We have gone into our submission in a fair bit of detail to show examples of recent decisions of the Competition Tribunal, where regulators have, I guess, overstepped their role in what they have to do - that is, assessing what is put forward to determine whether it is reasonable.

The clear example we have is the Moomba to Adelaide pipeline access arrangement approval process, where the regulator chose, through a desktop exercise, the lowest value. That value could not be established with an appropriate degree of precision and certainty because it wasn't determined using a tender process per se. The tribunal made specific findings that that compromised and severely prejudiced the legitimate business interests of the service provider, and the risks that that would cause to the future as a result of adopting lowest values through such a high-level desktop exercise created a severe example of asymmetric risk.

As I said, in our submission we also focus on coverage issues. Two specific points we would like to add to the comments that have been made in the APIA submission in relation to coverage go to the guidelines that a regulator has to set in relation to the monitoring form of regulation. It is our view that those guidelines should not be left to the regulator to develop, albeit in consultation with stakeholders.

It is our view that a body which has the jurisdiction to assess whether an asset should or should not be regulated - and, if so, the form of regulation that should apply; very much policy decisions to be made - should not have the administrative role of determining the form of regulation that should apply if it is monitoring. We believe that clear guidance should be given from an independent body as to the particular form of monitoring which should apply.

The second issue - and it is more so an issue of clarification - that we would ask the Commission to clarify is the duration of no coverage for a pipeline that goes through a coverage application, and a determination is made that it should not be covered. It is unclear as to whether the recommendation from the Productivity Commission is that it should be only 15 years or not more than 15 years, and we would ask that that be clarified as part of the final recommendation. We note in the Parer report there was a recommendation for 15 years. It is Epic Energy's practice that investment decisions are not made over anything less than a 20-year investment horizon. On that basis we would think that a 20-year period would be more consistent with normal business practice.

Turning to access arrangement, specific matters relating to the access arrangement approval process: as I have said before, and as David has also said, it is the role of the regulator to assess, not to set. That may appear to be a fine distinction, but it is an important one that has been borne out in the recent tribunal decisions. The removal of the 2.24 factors, as we said before, would create a serious risk of the regime not being effective, particularly given that the reference tariffs must be applied by an arbitrator if a dispute goes to arbitration, and we must point out that in Epic Energy's situation there has been no reference of a dispute to an arbitrator under the Gas Code since the inception of the Gas Code. Epic Energy's business is about getting new customers, not thwarting access to infrastructure. We believe that the threat of arbitration and the process of arbitration is actually the greatest threat that could apply for a pipeliner for it to be able to conduct its business properly.

The other point the Commission makes in its draft report relates to the application of coverage to extensions and expansion of pipelines. Based on our experience, we are of the view that there should be no differential treatment between expansion of capacity to existing infrastructure, as is the case for new pipeline investment. It is our view - and that has been reinforced by the Competition Tribunal in the Moomba to Adelaide Pipeline decision - that unless there is specific evidence that can be put forward that a pipeliner has abused or can abuse its monopoly power - to the extent that it has any monopoly power - then there should be no presumption that expansions to capacity of an existing covered pipeline should be regulated. That is a clear decision made by the Australian Competition Tribunal in its recent decision.

The other issue that we specifically draw out in our submission to the Productivity Commission is another aspect of the access arrangement approval process relating to new facilities investment - that is, the provisions in 8.16 to 8.21 of the Gas Code. It is Epic's view that those provisions require immediate review to ensure that there will always be a situation where a service provider is allowed to have the opportunity to recover its investment in new facilities investment - that is, expansion or enhancement to a pipeline system.

We have provided to the Commission, on a confidential basis, an analysis using real-life expansion scenarios of how the 8.16 test under the code would prevent Epic Energy, or a service provider, from having the opportunity of recovering its investment for that new facility's investment. There is no reason why a pipeline service provider should be prevented from recovering any costs relating to an expansion of a pipeline. The circumstances we believe that have caused the 8.16 test to work in that way is a lack of understanding as to how pipeline expansions work. We have provided that as part of our original submission prior to the draft report. There will always be significant differences in the costs of different types of expansions. The Dampier to Bunbury pipeline is currently moving towards a phase of expansion which is the most costly phase of expansion.

For it to carry out that expansion under the code would prevent it from recovering its investment in those assets, because the way the code works it essentially puts a cap on the tariffs, if you are not able to satisfy the system-wide benefits test, or the safety and integrity test. We consider that there is real risk and a lack of regulatory precedent to ensure that such expansion, such as compression or looping, would actually satisfy a system-wide benefits test. We are hopeful that a regulator would see the system-wide benefits merits of such an expansion, but there is a real risk that it would not be allowed to occur. For a service provider to have to undertake a regulatory - to get the certainty it would have to undertake a regulatory approval process well in advance of committing funds to the expansion.

That, in itself, requires a public consultation process to be undertaken by the regulator. That, in itself, therefore requires the service provider to have to disclose detailed information in relation to its proposed expansion project and therefore expose it to the risk of being gazumped by a competitor. We have an outworking of this currently in the east coast with projects proposed by Epic Energy. If we are required to go through an access arrangement, or a public consultation process to disclose information, we have the very risk that we will be gazumped by one of our competitors through that process, given that we have to run a regulatory approval process so early in a project's life to get the certainty that we require, particularly given that customers themselves are insisting on the most favoured nation clauses in their contracts.

The final point, I guess, is just a summing up and a reiteration of what David has said previously. That relates to the process that will be followed following the Commission's final report. The deliberative process that is to be undertaken by the Ministerial Council on Energy will ensure that there will be a lot more toing and froing about what should be included in changes to the Gas Access Regime and, more importantly, what might be meant by some of the recommendations from the Commission. It is therefore, we believe, critical that unambiguous, clear definitions and guidelines are put forward in the final recommendations from the Commission in its final report. We would be happy to take some questions.

MR WILLIAMS: Perhaps just before any questions, I might just make one final observation. That comes about, I suppose, very well in Australia with the Dampier to Bunbury natural gas pipeline and the filing that was made by Epic in relation to a proposed access arrangement there. The difficulties we face with the code, and I know that the Commission has endeavoured to address this in its draft report - one of the major difficulties that keeps getting mentioned as we go through is the question of the lack of flexibility. Why is it that an innovative approach that says, "The costs of Epic expanding pipelines is like a sine curve?" It goes up and it goes down, you can have very expensive times, you can have a very cheap times.

Why is it that a proposal that says, "We'll make it easier for everyone. We'll flatten that. We will make that a straight line. We will make it so that new entrants are not going to be disadvantaged. They can come in on the same tariff. We can make it that people that are looking for projects, that sometimes have 10 or 15-year lead times, have a knowledge, with a degree of certainty as to what the tariff will be in order to transport the gas down" - why is it that a proposal that seeks to address some of those major developmental road blocks that is set out for a period of 20 years, that involves a commitment by a service provider to take a loss-leading approach to expansion of the pipeline, in order to pick up in the later stages a higher returning level, but one which is a fundamental system that applies to everyone - why is it that the code can't accommodate that, or it appears that the code can't accommodate innovative and flexible thinking like that?

If we're going to kill off that sort of thinking and that sort of approach here, and in some of the ways of addressing issues Anthony mentioned over in the east, and we're going to get typecast into a very prescriptive approach as far as the code - which is fine perhaps in a very mature system of pipelines such as you might have in America, but which we don't have in Australia, we will get the sort of infrastructure that that breeds, which is a low-cost, non-flexible, just there to meet the particular demand, fully underwritten pipeline approach, and with little benefits or little thinking in order to provide general benefits all around. That's what we will get, and the Commission needs to be very careful, in dealing with its report, of continuing on with that prescriptive approach that you see particularly evidenced in section 8 of the

code, because that will be, and evidence will be, to the detriment of investment in expansion of existing infrastructure, but can also be a problem as far as new investment is concerned.

So a word of caution again - I know I've said this to the Commission before - be cautious about embarking too much down the path of what we've got in relation to the prescriptive nature. Step back and look at what have been the barriers, what have been the influences to the operation of pipelines since the national access code was first introduced, and maybe look at, "Is there a better way of doing it: a more open and more flexible approached coupled with, as Anthony was talking about, some very clear guidelines as to what is required by the people of Australia as far as the National Access Code is concerned? Happy to take questions.

MR HINTON: Thank you very much, David and Anthony, for those remarks, and thank you also very much for your submissions over the period of this inquiry, and thank you for your participation in the industry approach, that is, APIA's submission as well, which you've referred to this morning. Epic's involvement in this inquiry is appreciated, and we certainly acknowledge and pick up on your point that there have been distractions for your company. We are alert to them and therefore are doubly appreciative of your own personal efforts, David, and your company more generally, in this inquiry. So thank you.

I have a number of questions I would like to explore with you. They come primarily out of your submission, but also are alluded to in the remarks this morning, but probably not go into the APIA's submission as such, in that we have had some other public hearings on that. So we will try and focus on more Epic-specific matters if we can. There is no particular order in these questions I suspect, but let me pick up first of all on something you said, David, this morning about this lowest cost outcome approach that you perceive inherent in the regime, as currently applied, is generating a safety risk and a wider, longer-term risk with regard to infrastructure in this sector.

That has been said to us by some other interested parties as well, but has been countered by the regulators along the lines, such as the ACCC's comments, that the expenditures put forward by a service provider are usually taken as advised, and that it's not really a matter for the ACCC, for that matter, to get into seeking to carve into valid expenditures, particularly with regard to maintenance and particularly with regard to safety. So we have almost a non-debate here. We are talking across each other, I suspect. Can you sort of try and get us a better understanding of this non-debate?

MR WILLIAMS: I would love to. It's very easy to have a non-debate when you just pick out one aspect of an access code, which is operational expenditure. But as

I'm sure the Commission will appreciate, there are many aspects that go to making a business run, and a business run to meet its requirements of its investors, be they banks, be they shareholders. Of course, if you are not getting adequate returns, or if you are getting no returns at all, because of the regulatory squeezing down of your revenue, in effect a revenue cap which flows on to a margin cap almost, then clearly a service provider is going to look for ways that it can ensure that it achieves the objectives of its investors and it will have to balance what it would like to spend on operational expenditure, versus achieving a return to its investors, be they the banks, or be they the equity.

So it's all very well to say, "I've allowed you all your operational expenditure that you've said you're going to have in there, but effectively the impact of the code in relation to your return off capital and your return on capital is such that you really have no other money left." It's commercial human nature. I don't resile from it. I run a business that is there to make a return for my investors and I will look to seek for ways to achieve that return to them. As I said at the outset, I will not, never have and never will, compromise safety, the immediate safety. But it does mean, for example, that there will be expenditure that might be discretionary. There might be expenditure that I can push off. There might be expenditure such as in research and development.

MR HINTON: Yes.

MR WILLIAMS: Such as in training new employees with skills to come forward to take on apprenticeships, to take on graduate engineers. But clearly there is no incentive for me to go investing my money in that, and clearly where I can reduce the costs I can pass those over to a strained bottom line as far as my investors are concerned. So it's all very easy and noble for the regulators to turn around and say, "We give you every opex that you want," although it is very interesting when you see the CPI minus X approaches taken in the past. But let's just put that to one side, because there was a very clear statement from the Supreme Court of Western Australia that really under no circumstances should a regulator be seeking to second guess what an experienced service provider or operator of a pipeline believes they need to expend on operational expenditure, or even on capital - the same business, capital expenditure.

The real issue is that that's only one part of the equation. I've said time and time again that it's fine to focus on sorting problems out for the new pipelines, for the new pipeline infrastructure to be built, but if you don't fix up the problem that we've got with existing pipelines, you're sending the wrong messages as far as investment is concerned, and you will see that flow out - maybe not today, maybe not tomorrow, but in the long term, as things get pushed out - "Well, maybe we don't quite need to do that." That sounds as if we're going to go out there and run

pipelines in, flouting our pipeline licence and flouting the standards. We don't and we won't. When you have these sorts of distractions, when you have these sorts of strains, you're putting a strain on the system. You're putting a strain on the business that we shouldn't be putting on. That might come out unbeknownst to all of us down the track.

DR FOLIE: I just don't quite fully understand, because I thought that your operating expenditure and your maintenance - in other words, the ongoing costs of running the pipeline - that what the ACCC told us, you get all that money back effectively, so that if you skimp on it, then they can come back - perhaps that's the area that then you put forward a budget and then as time goes on, if you don't actually spend that amount, you can effectively put that to help giving you your running margin; so you can actually do better than what you put up.

MR WILLIAMS: Correct.

DR FOLIE: That's the dynamic that's driving you.

MR WILLIAMS: Otherwise they will come back at the next reset and say, "Well, you didn't spend it," so obviously what you're saying is you're over-egging it and, therefore, we'll draw it down for the next regulatory period. Yes, there are certain sorts of pressures and dynamics that - - -

DR FOLIE: We all know about budgets and how things change but, broadly, why wouldn't you just stick with that plan? In other words, if you believe a certain amount needs to be spent on maintenance, a certain amount needs to be spent on training over the period of time, why wouldn't you then just continue to do that, because if you've actually underspent and say you didn't need it, you will get caught at the next reset period? I just don't quite see how the regulator is actually causing - on operating expenditures alone, how that's causing a problem.

MR WILLIAMS: As I said, you can't look at operating expenditure alone.

DR FOLIE: No.

MR WILLIAMS: If you look at operating expenditure alone, it's very easy. I agree there's no debate, provided that the regulators hold true to that word. I don't necessarily accept that they have held true to that word in the past and certainly in our case - in the DBNGP case, for example, and I think also in the Moomba-Adelaide Pipeline, as I remember, there has been no discounting of operational expenditure. There have been some arguments about what is opex and what is capex.

To be fair to them, in the case of our two pipelines that have been subjected to that sort of scrutiny, there hasn't been an issue. That has not always been the case in some of the earlier decisions of the regulators. Maybe they've seen the error of their ways and they've changed, but you can't take it in isolation, because at the end of the day we have to run a business and at the end of the day you've got the regulator saying, "All right, well, I'll allow reality on operational expenditure, because, well, I'd be sticking my neck out if I told you to cut down on that, but I'm going to apply a theoretical approach to the rest of your business," and it's the rest of our business where we make our money.

If we're not making money out of there, we're not making an adequate return for our investors, then you've got to look for it to come from somewhere and I'm afraid that ultimately that will come out of opex and we will have these debates and, yes, we will get in there at the next reset and try and argue, "Well, we didn't spend it then because, well, it's going to happen now." We don't need these debates because we don't need to be constrained. We should not be constrained.

DR FOLIE: The next part of the same thread is that effectively then in certain circumstances what you want to do for - is there then a bigger debate between the two of you then when it comes to a certain amount of maintenance and safety? Is it of a time frame, so it's classified as capex and that's where the issue is that, therefore, you're not getting the return on that, because it's a new investment that's going in? There are difficulties about what goes into the capital base.

Without getting into detail about it, is that in some of these areas or are they trying to capitalise training, which they then say is a capital asset? There are these sort of debates where it can be blurring the edge about what is operating; in other words, what is ongoing expenditure, some of which may be legitimate operating costs and some of which may then be going into the capital base, because everybody is trying to defend the capital base in various ways. Is that where some of the problems - - -

MR CRIBB: Certainly on the DBNGP there has been an issue about proper categorisation of costs between opex and capex. I think the point we're trying to make through our submission is that 2.24 once again has the specific requirement to take into account safety and integrity issues. The removal of the specific reference to that consideration gives us cause for concern that in the future those particular issues will not be given the fundamental weight that 2.24 requires them to be given at this point in time.

MR HINTON: Well, we might come on to that a bit a later on.

DR FOLIE: Yes, we come to that later on. We will keep on the thread.

MR HINTON: This discussion takes us to your submission's reference to the ACT's recent determination and thank you very much for emphasising or focusing on recent decisions post draft report. We clearly have to take them into account, so we welcome submissions picking up those recent developments. One particular area that you focus on is this area that the ACT has determined it's not for the regulator to determine the parameters for an access arrangement. They should just respond to what is proposed and say whether or not that is reasonable.

Is this really an operational solution here - that is, doesn't that just shift the debate as to what would be the maximum permissible parameter, whether it be WACC or whatever? Does that particular ACT decision take us further with regard to improving the efficacy of the administration of the Gas Access Regime?

MR WILLIAMS: I suppose it does, but I think some of the issues which Anthony was trying to emphasise is the fact that there aren't clear guidelines at the moment, so we are ending up in these debates. How it will play out down the track, I think remains to be seen because clearly we've ended up down this path already. Will it mean, therefore, that the next time a pipeline comes up to have its capital base determined, that the regulators will accept that if it comes within a range and that range might be reasonably high - take the pipe costs example; you know, the selection might be towards the upper end of the range - that is reasonable?

Will they continue to sort of push for down the - they might not go down to the bottom this time. They might go to a pipe source from Greece, but they might go to the bottom 25th percentile, for example. We don't know, because there is not again a clear direction. It is very hard to be definitive and it's very hard for tribunals - either the Supreme Court or even the Competition Tribunal - to be definitive of saying, "This is what the rule will be." The reason for that is the very reasoning that was behind the whole original concept that came out of Hilmer and into the intergovernmental agreement - that you can't stereotype gas transmission pipelines in Australia. Every pipeline is different. The circumstances will differ for each pipeline and it may be in some circumstances you could go with a 25th percentile cost pipe. On other circumstances, again because of the significance of the infrastructure or the size of the project, you will tend to go to the 75th percentile, for example. Sometimes it can even be what pipe is available at the time.

I guarantee you if you actually looked at the market today and you were out there to build a large diameter natural gas pipeline - a 24-inch or a 26-inch - you are going to have a very very difficult time in sourcing steel pipe in the world market. As a result, the prices have gone up through there. Now, if we were doing an ORC today on the DBNGP, you might find it approaches $2 billion. I don't know. It could be significantly higher, because at this particular point in time you can't do it.

Of course we're stuck with the code or the way the code has been applied at the moment, as being, well, the tariff should be - or you determine the capital base at the beginning, at that particular point in time, and it's set once and for all, yet one might hypothesise that if you're truly trying to replicate competition, then what you should be doing is conducting an ORC test every day and, therefore - along with the other parameters, obviously, and the opex for that and the rate of return for that and the cost debt for that - that is what your true theoretical competitive costs would be. It's going to go up; it's going to go down.

Now, we sit back and say, "Well, you know, you can't really operate a third party access system that way." It doesn't provide any certainty. It doesn't provide certainty for the users, it doesn't provide certainty for the investors, so let's make a compromise and let's come in with a more settled approach. Because you're making a compromise - and it was the point we made before - because therefore it is a very imprecise situation we're dealing with, you necessarily have to go to err on, I suppose, a more generous way as far as the service provider is concerned, because they're the ones that have got the investment at stake, but bearing in mind that you've got to ensure the end user gets a reasonable deal. With all those parameters, it is very difficult to come with a very precise or very theoretical response.

MR HINTON: We have been focusing on areas of possible refinement improvement to the cost based price regulation regime characteristic that exists today and that's an important part of our draft report and will certainly be an important part of our final report; but we also put forward in the draft report a change in the nature of the regime by bringing forward this other tier of a possibility of monitoring. I noted that while APIA have views on this, your particular Epic submission also expresses the view though that that monitoring approach could lead to in fact more infrastructure being subject to regulation than currently prevails today.

That puzzles me, in that that certainly wasn't our intent in the nature of our construct that we put in the two tiers in the draft report proposals. Can you perhaps explain to me why you've come to this conclusion that under the draft report framework there could be more infrastructure subject to regulation than presently?

MR CRIBB: We sort of drew a line in the sand at the Eastern Gas Pipeline decision from the Competition Tribunal, which essentially says under the current code, unless there's going to be the likelihood of substantial promotion of competition, a pipeline should not be covered. Currently with the draft report we have the move from a tier 1 to a tier 2 level of coverage. It is predicated upon the same test. You then move to if it's likely to promote - materially promote-competition; you then fall within this monitoring form of regulation.

Immediately you have another level of regulation, although we would accept

that it's not an intrusive level of regulation if the monitoring regime were to consist of the code of conduct that we have been supporting through the APIA's submission. However, the issue we have is the information that has to be put to a regulator to determine the form of regulation that is to apply. What do you have to do to determine the difference between material and substantial? Do you have to put forward an access arrangement type of information to a regulator to say, "Well, that's what it's going to be under an access arrangement," and therefore the regulator is able to make an assessment of the difference between the material and substantial - the coverage regulator, this is.

It's very unclear from our perspective that even if you fall within the tier 1 range, the monitoring range, you still may have to put to a regulator - the coverage regulator - the level of information that you would have to submit as part of an access arrangement approval process. I think that's why we're suggesting - - -

MR HINTON: Yes.

MR CRIBB: - - - that the guidelines that need to be set out for the coverage decision-maker need to be very explicit so that we don't fall into that same level of intrusiveness that we've currently got. In effect, you end up with a monitoring regime that has already forced an approval process, the same of which is an access arrangement approval process.

MR HINTON: Anthony, there are several aspects to this. One is the concept and that, in the draft report, is driven by the view that you should only apply the more costly cost base price regulation regime where benefits are going to outweigh the costs, which is going to occur in certain circumstances of large market power - I will use the word "large" for a moment - and then we have monitoring for those where there's less market power; the concept being that that would reduce the application of the current regime's approach and then monitoring would apply to something less than that. Forget where the threshold might be relative to the coverage test today for a moment.

I assume Epic agrees or endorses that basic approach of seeking to have regulation only apply where benefits outweigh costs and, therefore, you don't object to what's in the draft report or the construct in the draft report. What you're objecting to is the parameters or coverage criteria that seek to apply that approach, would not deliver the desired outcome. Have I put words in your mouth?

MR WILLIAMS: Just as an opening comment - and I will let Anthony just deal with that more specifically - Epic doesn't shy away from regulation. It's the nature of our business. We're happy to have regulatory oversight as far as open access is concerned. We believe the negotiate-arbitrate model is all that is required at this

point in time in Australia. We don't believe the more expensive and intrusive costs of service approach is yet required in Australia, given the fact that is still an emerging industry.

Having moved from that point though, I think, yes, we accept that a lesser degree of monitoring is appropriate for clearly the scenario you outlined, but the situation actually comes down to - and Anthony will touch on this - how you draw that line and is it just monitoring or, in order to enable the price monitor to do his work in his eyes, that he needs all this information, which is essentially the same level of information you would be doing on the more detailed one.

MR CRIBB: Yes, I think from our perspective, if there are not clear guidelines given to the coverage regulator as to the level of information, the type of information that has to be disclosed through that type of process, you've essentially gone through an access arrangement approval process by default and from our perspective that's the very type of regime we're trying to move away from. We're endorsing a lighter-handed form of regulation. Our proposal was a monitoring regime of a type with a code of conduct underpinning that.

However, our concern, I guess, is that to get to that tier of regulation, what do you have to disclose to a regulator? Are you in fact having to go through a regulatory approval process akin to an access arrangement approval process? That's, I think, our major concern - that you're defeating the whole intent of your recommendations if it's not clear that that type of information shouldn't need to be disclosed.

MR WILLIAMS: If all you are after is, I suppose, an objective of ensuring that things don't start going for the worst or there are not spikes or that the current situation is suddenly getting out of kilter, then all it should need to be is a matter of price recording, so that you're building up the database - what's happening with the price? Is it suddenly moving up at a dramatic rate or are they continuing on as they are, or is there a differential between people? Are you starting to demonstrate anticompetitive behaviour or monopolistic behaviour? That should be all that's required, because in reality, when you come back to the Hilmer model and you come back to the fundamentals of the Competition Principles Agreement, the parties should be able to go out and negotiate their own access.

That's the fundamental tenet, the fundamental policy tenet, that sits behind all this. The parties should be able to go off and negotiate. If they can't reach agreement, then there is the fall-back that you can go to one arbitrator, who simply balances a number of different interests in determining what should be the appropriate outcome. No prescription, no regulator, no particular test: a very broad, flexible arrangement that if the parties need to resort to that then they can. If you

think about it in the categories that you were talking about - the category of the one where clearly there is a need for close scrutiny and the benefits outweigh the costs - then you might have a bit of an argument.

But when you come down to the second category and it really doesn't achieve it, why can't you resort - at the very least to that group - to that negotiate-arbitrate model which provides the flexibility if it's required; therefore you are getting, you know - you're not imposing costs on either of the parties. If they can get out and they can sort it out and they can't sort it out, then they can go to arbitration. If you constantly have arbitrations then you know you need to be doing something else; but we're not having that, as Anthony mentioned. We are getting on. It is in the interests of a company like ourselves to get on and negotiate deals and sort them out and get on with business. It's not in our interests to be involved in costly and time-consuming and distracting arbitrations.

MR HINTON: Yes. There are a couple of issues here. One is that we share and I think we certainly try in the draft report to make our intent clear, that we would look to have the monitoring regime to not default to a cost based intrusive examination of the entrails of the operations of a particular company. Rather, it would be trend information and performance driven - that is, performance focused; that is, if access is denied then that certainly is a key indicator. It wouldn't be a price issue, or it may be a price issue because the price being proposed is too high for the user, but it certainly would focus on the behaviour of the commercial negotiations going on with regard to this infrastructure and it would operate in a manner that commercial negotiation is clearly the intent, but it would be monitored in terms of how that is operating.

We would share your concern about a monitoring regime that led to the monitor, the agency doing the monitoring, getting down to a building block approach to see how that particular company is operating. That would be no improvement in the current structure of the Gas Access Regime. So pursuing that is important but we are also - and I thought we explored this in the draft report - quite uncomfortable with the default option being the negotiate-arbitrate model in that that usually seems to default to a cost based price process as well. The arbitrator, in seeking to reach a judgment as to disputes when they do occur, usually gets down to resolving those disputes by looking at a building block approach. That's the concern we've got of having that end result.

MR WILLIAMS: I think the mistake though, Tony, is that there is a natural assumption - and I know this was put up in the early days; I remember some of the discussions - that every access request will result in a matter before the arbitrator. I don't accept that.

MR HINTON: Access users left, yes.

MR WILLIAMS: I say to my people, to my managers and to my people dealing in negotiations with shippers, if you are ending up and you can't reach agreement then something is wrong. You're not doing the right job, because there is no value or benefit for us to be heading off to arbitration all the time. We are dealing with sophisticated parties when you deal with gas transmission pipelines. We're not dealing with the likes of you or I wanting gas into our house.

MR HINTON: True.

MR WILLIAMS: We're dealing with major companies in Australia who know the business very well, and we know it very well and we both know where we need to get to, largely. We will have debates and arguments when we're in that position but at the end of the day we will get there. You know, we each have different drivers to get there and those drivers will come into play, and I challenge the statements that are made by people that say, effectively, "We have to have regulation because we will always be in arbitration." I just don't accept that.

MR HINTON: Well, it's interesting you say from your perspective and the sort of drivers of your negotiations, what have you, would reach agreement rather than default to arbitration, but the signals we're getting from the users' group, those who are on the other side of the negotiations, the perception I have is that they tend to think that their deal is likely to be better if they get the arbitrator to do the negotiation for them.

MR WILLIAMS: I'm sure they do. We've had some discussions about that in confidence and I won't take that any further. You know my view as far as that perspective is concerned.

MR HINTON: Well, that's a difficulty that we had in seeking to ensure that if you go to improve the Gas Access Regime, that you don't in fact have improvements that default to the very thing that you're trying to avoid. That is why we were uncomfortable with your formulation of the monitoring regime in effect being driven by a negotiate-arbitrate model. Our approach is, one on which I would welcome your comments, that the threat of movement from monitoring tier to cost based tier should be a powerful driver of commercial negotiation, commercial activity and that is a key part of the construct in the draft report. We'd welcome your views on whether that is a valid, powerful driver of commercial behaviour.

MR WILLIAMS: Look, I think that the natural outworking of that, you're absolutely right. No-one wants to end up in a process where you're having to spend millions of dollars and particularly, as we've got the experience here in Western

Australia, of user pay and we see that the federal government's approach, as far as the Australian energy regulator, is to go to a user-pay approach as well. So we cop a double set of costs which you're not always able to pass on. But to put that to one side - I think a natural outworking is that, yes, it would be a severe push or driver on a service provider, whether fairly or unfairly - I want to come back in a minute before I finish on the first tier - to stay in a second tier and to behave itself to the extent that it needs to behave itself, as far as remaining under the monitoring approach. I did want to take you to task before, when you talked about - - -

MR HINTON: Feel free.

MR WILLIAMS: - - - key indicators would be that you couldn't reach agreement because that would indicate that you're charging too high a price. Equally, it can be that the customer is seeking too low a price. I can tell you I've had experience of that as well, so don't necessarily think that the indicator is always one way.

MR HINTON: I'm fully comfortable with your formulation.

MR WILLIAMS: Yes. Then we come back to the first tier and the issue about the first tier is where we are: that we've still got to get the first tier right and be careful about saying, "Well, you know, it's a good system where you have a monitoring tier because that will cause everyone to behave," because implicit in that, in a sense, is the fact that therefore there is something wrong with the first tier and why would you want to avoid it at all costs? So I suppose that's a bit where I take issue. Yes, as a natural outworking I think you're probably right, to the extent that it's required, but at that monitoring level I'm not quite sure that the driver is there. It's a problem if the first tier is not right and that's why you'd want to avoid it.

MR HINTON: You make a very important point, and I think we need to look at our words in the final report relative to the draft report, in that we do not see that force at work in the monitoring regime with the potential to move to the cost based price regulation regime as a punishment process. It's not a punitive aspect of bad behaviour. It's, rather, seen as where the behaviour is using market power excessively and therefore warrants intervention by this other cost based price regulation. It's not a question of punishing bad behaviour. It's a question of categorising a particular infrastructure's service provider's market power and I think we do need to look at our words there when we move from draft to final.

MR WILLIAMS: Certainly - and I think where you've picked up on in that point - there are different pipelines and Epic runs regulated and unregulated pipelines. It runs unregulated pipelines with multiple customers and we believe that we do that well and therefore it doesn't need regulation. On the other hand we would accept, for example, that the Dampier to Bunbury natural gas pipeline, being such a

significant infrastructure asset, probably would need to be regulated. Our beef is as to how it is regulated.

MR HINTON: Well, certainly part of our focus is on improving the cost based price regulation process as well. We think that's an important part of this inquiry's terms of reference. Still on this: I pick up, I think it was Anthony's reference, on the need for an independent body for decisions or at least recommendations regarding the form of regulation. The draft report construct is, the NCC, as the coverage recommender, would also make a recommendation on the form of regulation. NCC is independent. I assume that you are not referring to the NCC. You want someone else - another entity - to be advising ministers as to the form of regulation.

MR CRIBB: Yes. The issue I guess we have is if the NCC or the coverage decision-maker, coverage recommender, is able to assess what is the type of monitoring regime that is to apply, that blurs, I think, the ability for the coverage decision-maker to properly assess whether it fits within tier 1 and tier 2. Our view is that the coverage decision-maker should simply say, "Well, it's either A or B, or C - no coverage."

MR HINTON: Yes.

MR CRIBB: The form of regulation that should apply: we believe the code of conduct type of model that we're putting forward as our monitoring regime should be a "one model fits all" type of regime, or type of monitoring framework that could apply to everyone. So it's not simply do you assess the type of monitoring that applies on a case-by-case basis. That should be able to be determined by a different body than the NCC or the coverage decision-maker, whoever that might be.

MR WILLIAMS: That's essentially what we're talking about. I mean, it seems as if we're almost accepting that that monitoring regime is just a gathering of information and monitoring trends and looking at particular indicators. That should be spelt out. That should be common for all, and then it's just a matter of, if there are particular triggers, you go down another path. As Anthony said, it's got to be a different person from the one who has determined what category you're picked in.

MR CRIBB: What we are suggesting is that it shouldn't have to be left to the time of assessing a coverage application as to what is the form of monitoring that should apply. We're suggesting that there is a role for another body. Dare I suggest the AEMC that's being floated as the other body, a body like that which could make guidelines as to the form of the monitoring regime, or even the Commission in its final report, as to what would be contained as part of a monitoring regime. We believe that that's a far more appropriate way to set the goalposts so that the goalposts don't change down the track.

DR FOLIE: I think the regime was meant to be more or less generic - probably differences between transmission and pipeline because there are a number of things you've got to watch, but the intent of the report wasn't to have a specific monitoring regime suddenly being negotiated for every single pipeline. It really was meant to be a - and I think we were actually hoping for some further suggestions in this current round. We've had very few, unfortunately, and hence the debate, but the intent is to have - and our recommendation is broadly generic, but there will be probably differences between what's generic for transmission and what's generic for distribution.

MR CRIBB: I guess we still can't see how it's appropriate for the coverage decision-maker to be setting the goalposts for that monitoring regime. I think there needs to be an independent body.

MR HINTON: Those goalposts would not be changed for each particular infrastructure. They would be general, with their application being applied to any infrastructure being subject to monitoring, with Michael's point about nuances regarding distribution and transmission. So the NCC, in making a decision that yes, that particular infrastructure should be covered and it should be subject to cost based price regulation - fine, the ACCC or the state regulator then goes and does that, what is happening today. Or it could decide if it is to be covered it will be subject to monitoring, and the monitoring regime that will apply by the ACCC or by the state regulator will be done in accordance with this set of parameters, these sets of guidelines as to what is monitored, what is published and what is the requirement on the service provider with regard to publishing a third party access policy.

MR CRIBB: And as I read your draft report, you're suggesting that those guidelines be set by the NCC or the Commission.

MR HINTON: Not at the time of coverage.

MR CRIBB: Through another process.

MR HINTON: Yes, so that we in our report would say, "We think the parameters and guidelines for the monitoring regime should be this." In implementing that, governments would make decisions as to what would be the precise characteristics of that monitoring regime, and we've suggested that the NCC do that because the Commission is no longer involved when we've made our final report. The NCC would do that in consultation with the likes of industry - APIA, Epic, distribution networks, whatever - so then before, prior to, ex ante, there would clear decisions by government that the monitoring regime that would operate would have those characteristics.

Then the system is in place, it's operating, a decision is made by the NCC as to whether or not it would be covered and, if it is covered, what would apply. The parameters for the monitoring regime have already been established, and once a decision to monitor occurs, the NCC is not changing the guidelines; it's not changing the pricing principles.

MR CRIBB: I think, as we've learned from experiences, these guidelines may need changing over time - - -

MR HINTON: Exactly.

MR CRIBB: - - - in which case is it appropriate for that very policy - that's very much a policy decision.

MR HINTON: Would go back to ministers.

MR CRIBB: Well, should that be left to the NCC and we say no, that's not right for the NCC to be conducting a process that would lead to a change of those guidelines. That's what we say is inappropriate - for the coverage decision-maker to be undertaking that process.

MR HINTON: Thank you for elaborating, clarifying that. We know where you're coming from. We're running out of time. Let me touch on expansions and also pick up a response to one of your questions, Anthony. You pick up an ACT decision about expansions being subject to - if a pipeline is covered, an expansion of that covered pipeline, under our draft report's views, would also be covered. You've referred to a recent decision that suggests that should not be the case. The advantages of having automatic coverage, if it's covered to start with - that is, the pipeline - is that it removes the administrative burden of going through a process of evaluation.

That's driven by the view or based on the view that if a pipeline has been subjected to assessment and the coverage decision has been made, it's very difficult to see how you could sustain a case that the expansion of that pipeline should not also be covered whereby the owner, the service provider, would have the same market power with regard to the expansion as it does for the existing infrastructure. Prima facie, therefore, if it's covered, why shouldn't it be covered in terms of expansion?

MR CRIBB: Based on our experience, we would not expand a pipeline under the regulatory framework, using the current access arrangements system that applies, so from the start you have a real bottleneck there as to how you then expand. Do you

expand solely to meet your customers' demands at that point in time, which we argue is not the most efficient way to expand a pipeline, or do you take the risk that you might be able to increase your tariffs to reflect an opportunity to recover the entire investment? We point out the significant problems of the new facility investment provisions of the code to say that's a real risk that you're not going to be given that opportunity.

So you've got an immediate problem there of coverage of an expansion under the code that doesn't reflect the way you go and try and negotiate with your customers, because you're negotiating with customers to get that expansion up. It's very much the same way as you go and negotiate for customers for a new pipeline.

MR WILLIAMS: I think you also need to appreciate something, Tony - just to add on to that. It can distort your investment decision, and let me give you an example which might sort of seem an odd example but just to put it into context. You might be at a particular stage of the pipeline where there's a massive investment coming along. Someone is going to come and build a smelter, for example. In order to get it over the line and hence get that investment in the country happening, you might be prepared to do it at a much lower or almost an incremental cost because of some of the benefits it brings.

There might be some other benefits associated with it but you mightn't be going to get your full return or you might be prepared to take a lower return, for various reasons, and that can happen if it's a covered pipeline and, therefore, the capital gets rolled into the capital base and there is no recognition that you have taken a bit of a loss leader or you've taken a little bit of a hit in order to get that up. That flows through to the rest of your shippers. Therefore, the tariff for them will drop down and therefore you're not getting as much revenue from them as you were before. You've got to add that into your investment decision.

So instead of being able to look at that as a stand-alone investment and making your decisions accordingly, knowing that what you've got there and what you've got locked away with your existing customers is unaffected, you therefore necessarily have to look at what are the knock-on consequences as far as the other people are concerned. That can work either way. Will you make an investment decision to expand the pipeline, to invest more capital, on the basis of the regulated return or the regulated system?

This is where I come back to the point before: you can't forget the situation that existing pipes have. We've got our lot, whether it's here or whether it's in South Australia, or whether it's in Queensland, and other service providers have the same, but at least you know that that's, in a sense, ring fenced, because you can deal then with any new investment decision - and it is a new investment decision, as far as

expansion of a pipeline - on the basis of that new investment decision. If you're suddenly brought back where you're forced to bring it in as a covered pipeline - because I'll bet my bottom dollar that even if you don't want it in there, no regulator will ever agree to you keeping it out; that's a fact of life - you're then caught and that will therefore distort that investment decision.

MR HINTON: Okay.

MR WILLIAMS: Largely it makes more sense. It's complicated for us to have a variety of potential access arrangements for different parts of the pipeline. How do you work it?

MR HINTON: That's partly behind our thinking, too.

MR WILLIAMS: Commonsense will generally prevail but sometimes investment decisions are made on a particular basis. For example, the one in South Australia, the Pelican Point expansion, was made on a particular basis because we didn't have a regulatory decision at that point in time, so we were working out what was the situation for there, and we did a particular determination of the investment criteria there. We entered into an agreement, but that was also on the basis and in the knowledge that therefore that wouldn't impact upon the existing arrangements with our existing customers under those contracts or under the regulatory regime. You suddenly flip that around and you've changed that investment decision.

MR CRIBB: The key point that came from that tribunal decision was that there was no evidence that there existed market power for that particular expansion. I think that's a key point that needs to be drawn out - is that expansion doesn't necessarily fit the same dynamics as an existing covered pipeline might do.

MR HINTON: It was a useful catalyst for us to examine that part of our draft report. But that does relate to - in many ways you see expansion as similar to greenfields.

MR WILLIAMS: Similar, not exactly the same. I'll concede that. It's not exactly the same because you are dealing with an existing piece of infrastructure, and therefore I will concede and accept that in the case of some customers they are committed to that particular pipeline or that mode, but gas transmission pipelines are still in a competitive energy environment. We must never lose sight of that, particularly with power generators. Mostly they've got alternative forms of fuel that they can use. In the eastern states they've got alternative locations that they can use, and that will all sort of come into the milieu of how they make their investment decisions.

MR HINTON: We did seek to address the greenfields issue with this proposal for a 15-year regulation-free period and circumstances of passing certain tests. Anthony, I think you raised the question of what happens after 15 years. Put to one side the issue of some say it should be 20 years, some say 15 is okay, but whatever the period is, what happens after 20 years? You're expressing some uncertainty as to what we had in mind post 15 years, if I heard you correctly.

MR CRIBB: I think we first of all had the uncertainty of whether it was 15 years or maybe less. I think there are two parts of the report which suggest different conclusions on that point. Following that, I guess we accept that it's open to a coverage application being made at any time. If we're operating the businesses the way we currently operate them, we would see that there would be low risk of a pipeline successfully going into the access arrangement level of coverage. But I guess there is a real risk of, well, if it does, how do you then commence the assessment process? How do you set the tariffs in that instance?

MR HINTON: But the proposal is for a regulation-free period for 15 years and a binding ruling is binding for 15 years.

MR CRIBB: That's where I saw a little bit of uncertainty in the report as to whether it was 15 years or whether it might actually be scope for something less than 15 years.

MR HINTON: No, it was up-front tranche of years to give regulatory certainty with regard to that period. What happened at the end of 15 years, in the draft report's approach, was one of, then it is open for regulation to occur, which requires a discrete decision as to whether or not it is uncovered, covered - if covered, the form of regulatory intervention. It's as if it was being assessed afresh from that period - that is, at the end of 15 years.

MR CRIBB: I don't think we have a problem with that approach. I think the issue we have is, if you fall into the access arrangement form of coverage, there's uncertainty as to how that gets assessed during that process. That's a fair way down the track for any pipeline but it is something that we've probably got to provide more input into the Commission in the next month or so, I think.

MR HINTON: The difficulty we saw with this, for a regulator making a coverage decision to give a binding ruling for 15 years, would require a certain amount of detail as to the proposed greenfield investment. That raises questions of how far the proposal has been - what expenditures have been incurred in putting this proposal together and what sort of commercial-in-confidence considerations start to emerge with a board considering a significant, substantive investment in pipelines - may be a little reluctant to go to a regulator to get a binding ruling for 15 years - no regulation

if it could endanger the commercial-in-confidence aspects of that proposal.

MR WILLIAMS: That was the very issue that we faced with the Darwin to Moomba pipeline which we've talked to you about in the past - exactly that. Now, you want to accept an environment where you encourage investors and pipeline operators to come up with new ideas for new pipelines, and that's something I think very much the gas producers would like. I mean, the more pipelines being built to transport their gas around the country has got to be good for them. You've got to set an environment where you can just go and do it, and your ideas are not held out to public scrutiny - and why should they?

At the end of the day, if you can come up and you can make a pipeline work, you've actually had to compete in the market to get the market to do it - it just doesn't exist. So why shouldn't you - I mean, what could be a better example of the market forces and competition at work than in a brand spanking new greenfield pipeline which you've done on the back of negotiated contracts with the customers, or you've gone in taking market risk, hoping that the customers will come across? At the end of the day, we are in an energy market; we're not in a natural gas market. We're in an energy market and we're competing with different forms, or we're actually competing to come up with a viable delivered gas price that will help new projects work.

There really is no place for regulation in that situation and that's where the Parer recommendations I thought really hit the nail on the head, when they sort of said, "Well, you shouldn't have it. You should definitely have at least a 15-year period free," and then let's look at it from thereafter to see whether you start exerting market forces because at the end of the day, if you're not, why do you want to interfere? That might be where you move into that issue of the monitoring aspect, just to check to see to get the benchmark, to check to see how things are going forward. Why interfere if it's working? Why fix something that's not broken?

MR HINTON: That does take us to my last question, particularly looking at my clock. You have expressed views in your submission about a national energy regulator and in fact you cast quite significant doubt on whether or not benefits would flow from having a national energy regulator. Can you elaborate a bit more on this view? I thought there was fairly widespread support for a national energy regulator.

MR CRIBB: I guess the frustration that Epic Energy experiences at the moment is very much the focus on institutional reform without focus on the underlying framework that is to be applied by the institutions. While we really appreciate the work the Commission is doing, we feel that it is the cart before the horse approach at the moment. The focus seems to be on a super-regulator, which we don't necessarily

see; we don't see that there is any evidence to justify the move to a super-regulator. If you have got the underlying framework that is being applied, it shouldn't matter whether you have one or six bodies applying the correct underlying framework.

I guess our concern is that the scarce resources that everyone has to focus on reform seems to be distracted to the institutional reforms at this point in time without focusing on the key issue that needs to be reformed, and that's the underlying framework to be applied by the institution. We're concerned that there is that loss of focus and we're concerned that there is really no evidence that there will be a savings in cost to anyone concerned, particularly if the broader industry has to bear the costs of this regulator, which seems to be the proposal at the moment. There is no evidence to suggest that that will lead to savings to customers; in fact the opposite seems to be the case, from experience in the United Kingdom.

MR WILLIAMS: Just to deal with that last point first, I think the cynical amongst us might make the comment that this is just a ruse to remove costs from the bottom line of various governments and to pass it on yet again to the poor, long-suffering service provider of gas transmission pipelines, because nowhere - nowhere - that I have seen do they talk about the means of recovery. It hasn't been proposed to do it in a FRC style in the US, where the government simply determines what the cost is and we become a collector, in a not dissimilar way to GST, and have no issues with that, despite the fact that that will add a cost to us, but we'll have no issues with that, but where we are put in the position of holding the regulator accountable for his expenditure and his behaviour therefore is unreasonable, as well as unfair, because at the same time we have to deal with that same regulator in discussions on our access arrangement.

To come back to the bigger issue - and this is something which we have constantly said - there is no national energy strategy. There is no-one prepared to stand up and take leadership and development of that strategy and, until we work out what the country's long-term energy strategy is, we shouldn't be fiddling around at the edges. We have a policy set out in the Competition Principles Agreement that makes no reference to a regulator - it talks about a negotiate-arbitrate model - and yet that strategy, or that policy statement, has simply been consigned to the bin, I'm sure never to be seen again, and yet that is the underlying framework that we are meant to be operating on.

Until the government - all the governments - step back and say, "What is it? What is the strategy that we have going forward as far as energy requirements and energy shape in Australia? What therefore do we need to ensure that we get that energy strategy or energy shape?" we are going to continue on with the sorts of problems that we are developing at the moment as in the level of electricity generation that is available, as in the form and the nature and the location of gas

pipeline infrastructure, and so on. We are fiddling with the minutia. We are not stepping back and saying, "What is it that we need as a country in order to ensure that we have got the proper energy requirements that suit our long-term vision as far as this country is concerned; that will match the sort of industry development this country wants out into the long term; that has the energy mix?" and it will be a mix.

We don't advocate that it is all to be natural gas - far opposite. We believe that natural gas is an important component, but until you have the leaders of this country and the leaders of the states determining a strategy, how can you start fiddling around with this sort of stuff because you might end up doing exactly the wrong thing or providing the wrong drivers because, again, how do you know what your overall objective ultimately is that you are trying to achieve as far as this national access code is concerned. Now, that's not a criticism of the Commission - quite the opposite. The Commission, I think, where it has been able to, has looked in the broader scope. It is a criticism of the governments because they have not picked up the leadership to develop that national energy strategy.

MR HINTON: Thanks Michael.

DR FOLIE: I'll be brief because of the time. You have made lots - and we have noted it - of comments about actually we have an overarching objective, and then the sub-objectives. I don't want to go into great length, but I would just like to respond. We consider that in our overarching objective, and also the deletions we put in place, embedded in the words in the overarching objectives we have - that we meet the issues of Hilmer and the other groups. Now, it may well be - unfortunately this dreaded word about efficiency and things in there - that a better linkage and understanding of what - in other words again, the background behind those words.

We believe we have captured a lot of the spirit, without getting into the minutia about taking all these factors around the source of the problem - are that the more factors you put in the more you open up to the weightings and the other things, and wouldn't - appear that a lot of the judicial findings that are coming through are not incompatible - what we believe the interpretation of the words is - so is it the lack of clarity as to what our definition - what is behind our minds - would that make you more comfortable with your response to that?

MR CRIBB: I think the first point we have tried to make in our submission is - particularly the role of a regulator as assessing what's reasonable - that should, we believe, overcome a lot of the problems that regulators have conceded they have in applying the code at the moment; you have regard to all of these factors and look at what the service provider has put forward. I don't necessarily think that the debate then moves to, well, what is the end point - the high point and the low end of a reasonable range.

I actually think that it makes it easier for a regulator to say that the reasonable range, having regard to the 2.24 factors, allows for the approval of what has been put forward by the service provider, bearing in mind that that is what an arbitrator has to do when they carry out an arbitration under the code because that is what is required of an arbitrator under the Competition Principles Agreement. So I think if we remove those same considerations from a regulator's job that are the considerations that an arbitrator has to take on board, we do run a serious risk that the outworkings of the regulatory approval process will be based on a significantly different set of considerations and therefore risk a significantly different outcome, which might arise under an arbitration process.

Secondly, I think, we say that the court - particularly in the Dampier to Bunbury decision - came to a conclusion that economic efficiency is generally understood to encompass a number of themes, but those themes are not capable of precise definition, so are we actually achieving any greater certain in moving to the term "economic efficiency"? I think we run the risk that, as the court said in the Dampier-Bunbury decision, we have a piece of legislation here which embodies social public interest, economic and other dimensions, and those have to be considered and applied by a regulator and by an arbitrator.

So if we are focusing solely on economic efficiency we need to make it clear that the overarching objectives clause embodies those very dimensions that the court said are consistent with the original intent of competition principle reform, so our submission has been that if we are moving to that overarching objectives clause it has to make it very clear that that does embody the 2.24 considerations.

MR WILLIAMS: And just to follow on from that, I think again the danger in the recommendation approach of cherry-picking - of getting rid of some of the factors, but leaving some in - I mean, either you are trying to get that overarching objects clause to cover everything or you're not. You can't go halfway, and it seems to me in looking at the recommendation - and obviously Anthony has got a much better grasp of it than I do - is that you have only gone halfway because you recognise you haven't got there with it.

But some of the stuff you're pulling out causes me great concern, as I mentioned before, because of some of the comments and the debate that went on in the DBNGP case, particularly about that term "economic efficiency" and the uncertainty about where it comes from, but does it really pick up things such as public interest? Does it really pick up legitimate interest of the service provider? Does it really pick up the interest of prospective users and so on?

The difficulty, I think, even apart from the technical aspect of, do you still comply with clause 6(4) of the Competition Principles Agreement, is that it is putting

too great an emphasis on economic efficiency, which might be read as "short term" as opposed to "long term". Maybe you could fiddle with the words to say, "Having regard to the long term" or "economic efficiency in the long term" or something like that, but the difficulty is, I think if you go down that approach by trying to have that objectives clause covering everything, then you really have got to therefore have nothing as far as underlying factors. It's all or it's nothing, and that's the difficulty you face. You run the risk that you are overemphasising some of the points with what you are leaving behind as opposed to the complete package of the factors that underlie that overarching objectives clause.

MR HINTON: Thank you. Are there any matters that we haven't focused on that we should have focused on?

MR WILLIAMS: No. You have given us a fair hearing, Tony and Michael and, as always, we welcome the opportunity to sit down and discuss our views and to get the rigorous challenge, and I think that rigorous process you conduct is going to produce a good result within the parameters you are given - and I emphasise that: within the parameters you are given. I think we have said our piece; probably more than said our piece.

MR HINTON: Thank you again very much for your participation here today and for your submissions over the period of this inquiry.

MR WILLIAMS: Thank you again for the opportunity.

MR HINTON: We're scheduled to take a coffee break, but we are running late. The next session was scheduled to commence at 10.45. It is already 10.45. Why don't we come back here at 5 to 11. Give you 10 minutes for coffee and I apologise to the next people for the 10-minute delay. Thank you.

MR HINTON: Welcome back to this second session of the Productivity Commission's public hearings here in Perth. I now welcome to the microphones representatives of WMC Resources, Mr John Harvey and Ms Cassandra Walsh. It's a pleasure to have you here. Over to you to set the ball rolling with a statement, please.

MS WALSH: Just by way of introductions - you've met us both before - I'm Cassandra Walsh. I'm a corporate lawyer with Western Mining and John Harvey is the manager of energy supply and has a lot of involvement with gas issues in Western Australia, Queensland and South Australia, where our operations are. We only intend to make a brief submission today.

You'll see from our written submission that we basically have broken it into two parts. We've made some general comments about the Productivity Commission's review of the Gas Access Regime and, following that, we've made some specific comments in relation to some of the recommendations that we feel we could add some information to. We haven't gone through and commented on all of them, and we don't intend to go through all of them this morning. I'll hand over to John, who was going to give a bit of a broad overview of our thoughts generally about the Productivity Commission's approach to the regime.

MR HARVEY: I guess the first thing that comes to mind is that we believe the Gas Access Regime should be focused solely on third party shippers and not foundation shippers. We believe foundation shippers are in a position to negotiate their own contracts. Clearly, certainly in Australia, foundation shippers tend to underwrite the investment and then third party shippers come along after. A logical extension would be that in normal circumstances you'd expect the third party shipper not to enjoy better terms and conditions than the foundation shipper.

Over the course of time, that can clearly change. That would be generally as a result of an increase in throughput or demand on the pipeline so that the unit costs would, in fact, come down in real terms. In that case, we believe that the foundation shipper should benefit by paying the third party shipper tariff, if it is lower than what he has contracted. Clearly, if the regulator bases his tariff or terms and conditions on foundation shipper contracts, then you're going to have the case where you'll get fit-for-purpose pipelines, in our view.

We see that the foundation shippers and, obviously, the pipeliners should get together, determine what is an appropriate way forward and then the third party shippers should come along. They would probably not enjoy the same terms and conditions, and there would be some room to negotiate. That would avoid the fit-for-purpose pipelines. There still would be some blue sky in it for the pipeliners by negotiating with the third party shippers, but if there are not a lot of third party

shippers available immediately anyway it doesn't matter, because it's already an economic investment with simply the foundation shippers. I guess the main point there is that the regime should focus on third party shippers.

In our view, there's only a need for minor changes to the existing regime. As I say, there should be no presumption that third party shipper rights are the same as foundation shipper rights. For the initial review, regulated tariffs should certainly be greater than foundation shipper tariffs. As an overview of the regime, they're our primary comments. I'll now hand back to Cass for some more detailed comments.

MS WALSH: I guess what we really intend to do is just to make a couple of points summarising our position that we've put out in our paper. The first point that we would make is in relation to draft finding 2.1, where the Commission notes that, while transmission pipelines do exhibit natural monopoly characteristics, the market power of the transmission pipeline owners is constrained by a number of factors, and I think you've referred to the availability of substitutes, the size and concentration of users and the elasticity of demand.

I guess we would like to point out there that there appears to be little significance attributed to the lack of bargaining power of pipeline users, which are completely dependent upon the services of a particular pipeline. That's particularly the case, I think, in Western Australia, particularly in the goldfields region and a lot of the mining and industrial clients there. You've pointed out that coal is often a viable substitute for gas. I guess our experience shows that, whilst this is true in many cases, I think that the Commission overstates that in relation to the mining sector as well. For example, for us coal isn't a viable alternative to gas.

In relation to draft finding 2.3, the Commission notes that the market conditions have changed considerably since the introduction of the Gas Access Regime. I think, whilst that's true to some extent, the Commission has to a certain degree overstated the extent of competition which does exist in the provision of gas transmission services. I think, once again, this is illustrated by the situation that we have here in Western Australia, where there's very little competition.

I think that our main point there is that the Commission overlooks the necessity for certainty, both in relation to availability of supply and price, that both users and potential users are seeking as part of their investment decisions. We think that at this stage still competition hasn't evolved enough within Western Australia to allow that to happen without the regulation that the Gas Access Regime currently provides. I think John had some particular comments in relation to investment and whether or not the Gas Access Regime does, in fact, distort or deter investment.

MR HARVEY: Draft finding 4.3 really concludes that the Gas Access Regime

deters and distorts investment in pipelines. We think that's theoretical and it seems to be only supported by anecdotal evidence. If you refer to figure 4.2 in the Commission's findings, there's been a clear increase in transmission pipeline capex. I think there's an assumption that there has been some regulatory risk and that's increased overall risk, so therefore investment has been deterred.

We believe that risk has been overstated. The pipeline risk, in general, is underwritten by foundation shipper contracts, as we were discussing earlier, which is unaffected by the Gas Access Regime. The Gas Access Regime is really talking about people who come along after the event. We have problems with that draft finding. The other thing - that draft finding then goes on to discuss favoured nation status. From my earlier comments, we certainly support favoured nation status. We believe it's logical and commercial to retain a favoured national status. Over to you, Cass.

MS WALSH: Which leads us into draft finding 4.5, where I think that the Commission found that regulation involving access arrangements with a reference tariff should be considered only where service providers have substantial market power.

> Where market power is not strong, such as where there is emerging competition in the gas industry, the long-run costs of regulatory intervention are likely to outweigh the cost of the market failure that regulation attempts to correct.

It seems to me here that the Commission has found that the long-run costs of regulatory intervention exceed the cost of market failure, which is obviously designed to be corrected by regulation. I think this is where we start to get the idea of monitoring or a lighter-handed regulation as an alternate form of, I guess, what we would call full price regulation as currently exhibited by the Gas Access Regime. We'll discuss that in a little bit more detail later, because it pops up under some other regulations. I guess it's worth noting that, in principle, WMC isn't necessarily opposed to light-handed regulation, but the difficulty is finding the mechanism which enables it to be implemented in a way which will provide the service provider with sufficient disincentive to misuse the market power that it otherwise would have.

Our reading of the report at this stage is that the Commission hasn't really proposed a way to ensure that this sort of abuse doesn't happen. There needs to be an immediate and credible threat to misuse of market power under any form of lighter-handed regulation, and we don't see that in the recommendations as they currently stand.

By way of example, over past years the aeronautical industry has undergone

sufficient reform. Whereas the ACCC used to monitor the price caps and the ACCC had to receive prior notification of increased charges, this was abolished by way of a monitoring regime. A study that was completed only a couple of months ago now, which looked at the airports in all the major cities around Australia, noticed that the average prices that the airlines now pay for aeronautical services had increased significantly. I don't know the figures exactly, but they were somewhere between 40 to 160 per cent. That sort of study gives us some concern because, whilst a monitoring regime is okay in principle, if such great price increases are able to occur under that sort of regime, it would tend to imply that the service providers are actually able to charge the monopoly rents that are otherwise not meant to be charged under the regime.

We don't have the answer as to how you provide such an incentive to ensure that that doesn't happen, but I guess we just raise the question. It's something that needs to be addressed. Generally, we think that the threat of a return to full price regulation probably isn't sufficient in the circumstances, because it's really returning to what would otherwise have been the status quo in any event. Did you want to add anything in that regard?

MR HARVEY: No, I think that's fine.

MS WALSH: The objectives clause - we note merely that the Commission recommended that objective A, which was obviously the interests of pipeline owners, and objective F, which are the interests of users and prospective users, be deleted because they're inconsistent and irreconcilable. Whilst we acknowledge that they are, in fact, looking at different ends of the spectrum and looking at the interests of opposed parties, to a large extent, we say that it's for that very reason that they should stay, because it encourages the regulator to take a balanced look at the interests of all parties involved in securing access to transmission and distribution pipelines.

In relation to coverage, the main point that we would like to make is that we think that the coverage regime works pretty well as it is and that the criteria are adequate. Accordingly, we would submit that the coverage shouldn't be made more difficult and we're concerned that some of the recommendations proposed by the Commission mean that parties seeking access will be unable to obtain access in a time frame which will enable them to make the most of a competitive market.

I alluded to this earlier when I was talking about timing, because obviously in any competitive market the decision to invest in infrastructure projects - anything like that - is clearly very important and delays in any sort of access regime which prolong the ability to make that decision cause financial detriment, and I don't think that can be seen in a positive light at all.

We note that, to the extent that the Commission recommends amendments to the coverage criteria, it would probably be sensible to make that consistent with the government's response to the ACCC's comments on Part IIIA of the Trade Practices Act. We think really that any term "material or substantial" is ambiguous in any event, and we suggest that there's probably a qualitative uncertainty associated with both of them, but we would prefer the stance adopted by the government in the response to Part IIIA. We believe that the criterion of economic efficiency, which I think the Commission proposed to introduce as a new criterion C, is probably not necessary given the existence of criteria A and B.

MR HARVEY: Going on draft recommendation 6.7, which really is the follow-up on the monitoring regime as discussed earlier, we believe the five-year period for a monitoring regime is too long. We think that would leave the pipeliner with an opportunity to extract monopoly rents without any fear. We actually believe there should be a circuit-breaker in there where an access seeker who is unable to negotiate satisfactory terms could approach the NCC and perhaps - if he was able to obtain access, but on terms that had not been agreed, then a backdating could apply, so that if an arbiter came along and determined what the terms would be, they would be backdated to the date of the complaint.

We draw attention to the example that Cassandra raised earlier about the airport, with up to a 160 per cent increase in two years. We believe that there must be a credible threat. If monopoly rents are being charged, then the regulator should have some way of intervening. They are our concerns with the monitoring regime. With respect to multipart pricing, we would support multipricing or in fact justifiable price discrimination we would support. However, there is a prerequisite there, which we make in our submission, that there would need to be a secondary trading of contracted capacity. We would also be a bit concerned if there were some extreme examples of multipart pricing, such as the poll tax arrangement.

Another one which I think the Commission asked for comment on is the use-it or lose-it proposal. We are strongly opposed, in principle, to the confiscation of capacity rights. We think it's much better to encourage secondary trading. In order to answer the question, what compensation do we think would be acceptable if capacity rights were to be taken, we would seek compensation of the full costs at the third party tariff. We also think the originating shipper should have the right to reclaim the capacity with adequate notice. In principle we don't go along, but if it must be there, we would like to see some conditions on it, okay?

MS WALSH: I would just like to say something else.

MR HARVEY: Sure, okay.

MS WALSH: I think it was draft recommendation 7.3. You touched on the issue of consistency across jurisdictions and that was particularly in relation to the requirements for establishing and maintaining information. We support that recommendation. Really we don't see any reason why the requirements for establishing and maintaining information shouldn't be uniform across the jurisdictions.

To take that a little bit further, we note that, for example, in all jurisdictions other than Western Australia, any review of ministerial decisions goes to the Australian Competition Tribunal, whereas in Western Australia they go to a gas review board which is comprised of, I think, a panel of legal practitioners and experts which are appointed by the governor. We can't see any benefit in retaining such a discrepancy between the states. I guess to that end we would actually acknowledge the benefits of any review being conducted by the ACT, as a Federal Court judge with experience in these issues, particularly in competition matters, will actually be involved in hearing the review.

An additional point in relation to the consistency issue we have is in relation to coverage. Whilst we acknowledge that the NCC makes the final recommendation to the relevant minister, depending on where the pipeline is situated, in relation to a pipeline owner's revocation for coverage, obviously the minister differs according to the jurisdiction in which the pipeline is situated. Should the minister choose not to endorse the recommendation by the NCC, there isn't always a consistency in the outcome; meaning that there's no consistency across the jurisdictions, making it hard for such issues to be determined and, I guess, assessed in a balanced environment.

We would probably take that one step further, to say that ultimately it shouldn't be the minister who is the minister responsible for the administration of each act, who is responsible for determining issues such as coverage. We would argue that the NCC is probably the appropriate body and would like to see the code amended to take that into account.

MR HARVEY: I'm glad you made that point. That's a very relevant point, in our view. We do think there is some inconsistency there. In summary, we believe the existing regime is adequate, with minor changes. We take the point that competition is emerging, but it's still embryonic at this stage. Certainly in Western Australia there is very little competition and that needs to be taken into account. We note that there is strong growth in pipeline investment. There has been historically and we are looking at some investment in pipelines right now and there is a lot of interest out there.

I guess there are three comments I would like to make, three closing comments. The Gas Access Regime should be directed towards third parties and not

foundation shippers. We believe coverage criteria should not be made any more difficult than it already is. Finally - and I think a very important one - is to avoid an overreaction to the teething problems that we're having at the moment. I believe the regulator has had a lot of problems, but a lot of them are teething problems, centred around initial capital base. They will not be a problem in the future, or not as much of a problem. I think that needs to be taken into account before we make changes to the access regime.

MR HINTON: Thank you very much, John and Cassandra, for those comments and also thank you for your submissions over the period of this inquiry. WMC Resources' perspectives on these issues are important for us, so thank you very much for your participation. I have got a couple of reactions to your comments this morning and your submission. It's in no particular order, but the first one I would like to take up is one that I think John emphasised on at least three, if not more, occasions. This is picking up this point that the regime should focus on third party users, not foundation contract holders - foundation customers.

I am puzzled about this in the sense that third party access is about third parties, but intervention by a regulator that touches on the terms and conditions of that access for third parties can have direct relevance to an impact on foundation customers.

MR HARVEY: Yes.

MR HINTON: It, therefore, prima facie, in my view, would be important that the regulatory regime be constructed in a manner that sets down parameters as to how intervention could appropriately or, more importantly, inappropriately, impact on foundation customers. Therefore, I am a bit puzzled why you are making this point with such emphasis. I would have come the other way at it and say, sure, third party is third party access, but there are implications for foundation customers. What am I missing?

MR HARVEY: I think the fundamental is that we need regulation in the absence of competition. I think most people would accept that regulation is probably a poor substitute for competition. In our view it is a much better alternative than market failure. Now, if you're a third party wanting one terajoule per day down a pipeline, you have little or no bargaining power and you're vulnerable to monopoly rents, because there's no credible alternative. You will hear things like, "Oh, but coal or diesel is an alternative." Well, the price of gas is 2.50 a gigajoule and diesel is, what, $12 a gigajoule. Sure, it's a threat, but it's not very credible.

Now, if you're a foundation shipper, the credible threat is that you don't build the pipeline. You know, you do have some negotiating power. Generally those

foundation shipper contracts are long term, so that you have entered into a foundation shipper contract and the regulator's decision may or may not affect you. You may have a clause in your contract that says, well, if the regulated tariff is lower than the one you've negotiated, then you get the benefit of it; but you're not dependent on access. You already have access and you have access on terms that you've agreed. That's why we make the distinction between the foundation shippers and the third parties.

I guess the secondary part to that is it's important, in our view, that the foundation shipper contracts don't become the benchmark; because they have been negotiated on terms of adequate security, long-term contract, take or pay and all those sort of things. If that becomes the benchmark - - -

MR HINTON: A conjunction of interests.

MR HARVEY: - - - it becomes really difficult, I think, for the pipeliner to negotiate, because that's close to the best deal they can come up with. We believe there should be some room between the third party and the foundation shipper, which may evolve over time, but certainly initially, which allows the pipeliner to extract an adequate rate of return.

DR FOLIE: I am just puzzled a little bit, because in some ways you were saying that they're allowed to make monopoly rents from the third parties because they will invest in the pipeline, let's say, for a normal rate of return. You end up with your argument and then in the end if they - and no doubt the little bit of judgment about how long it might be before they get any third party access, if third party access comes along relatively sooner than they thought and you encourage them to get a higher price, that implies that if you run the ruler over it doing all this detailed forensic intervention, that the regulator might come out and say, "Well, they're actually getting too high a rate of return." Have you allowed in that circumstance or why wouldn't you, say, revert back to a price very close to the one the foundation shippers had?

MR HARVEY: We're certainly not saying that the pipeliner should get monopoly rents; far from it. We are simply saying that in determining foundation shipper contracts, they are based on long-term, more security than most; basically a privileged position. If the pipeliner is forced to pass on that privileged position to all and sundry, then you will get fit-for-purpose pipelines. We don't want to see fit for purpose. We think it's not economically efficient. We want to encourage the use of the pipeline, so that means price discrimination - in our view, justifiable price discrimination.

DR FOLIE: But isn't the pipeliner making the decision that he will either make it

fit for purpose - which has happened allegedly in parts of Australia - or he builds a much bigger one, hoping that other business might come along and that's part of the risk he's bearing - that incremental capital cost risk.

MR HARVEY: Yes, quite so.

DR FOLIE: It's not your concern as a foundation shipper, provided you can meet the contractual terms which may be capacity growth over the life of the pipelines. Provided he delivers gas to you, that profile, why worry about how big he makes the pipeline and what he does then with other third parties?

MR HARVEY: Look, I accept that is the shipper's prerogative. However, we think the Gas Access Regime should encourage and promote investment. If it steers the pipeliner towards fit-for-purpose pipelines, then I think to a certain extent it has failed, okay? I believe if the foundation shipper contracts become the benchmark, then that's the way we would be going and we don't think it's appropriate. You know, if you've got, let's say for a round figure, 100 TJs a day going down a pipeline, right, that's your forecast flow, and the foundation shippers are 70 TJs a day spread, let's say, between four shippers. I think it's logical that those four shippers should enjoy better conditions than another 25 shippers that are sharing 30 TJs a day. That's the point we're making.

From the pipeliner's perspective, if he is going to have to be forced to pass on those privileged terms and conditions to the third parties, then there's little incentive for him to build the pipeline other than fit for purpose. That's what we're aiming at.

DR FOLIE: Okay, that's the point.

MR HINTON: So you would want the regulator to have pricing guidelines in setting a tariff for third party access that directly instructed the regulator to in fact, in effect, charge a higher price for third parties than for foundation customers.

MR HARVEY: The way we see it is that the pipeline - the tariffs should be set as if everyone was third parties, okay? The fact that the foundation shippers, by virtue of what we've discussed, are able to extract better conditions, shouldn't come into the regulator's reasoning.

MR HINTON: So this is your price differentiation.

MR HARVEY: Yes, correct.

MR HINTON: Thanks for that, John. Let's move on to coverage. I think it was Cassandra who referred to problems about the criteria in the draft report, and this is

reference to the terms "substantial" and "material". I don't want to get down to too much detail regarding the meaning of those words at this stage. What I rather want to do is touch on your point that you have a concern about the application of this coverage criteria and then go to a proposal that the NCC just should have discretion in making a coverage decision as to what sort of formal regulations should apply.

Now, you've got problems with the criteria we put up and therefore you say, "Because there are problems with those criteria, let's give NCC discretion as to whether or not they would impose regulation through cost based price reform or a monitoring regime." My immediate reaction to that is, how does NCC make a decision and, if it's subjective without explicit criteria, doesn't that have huge uncertainty with regard to the sector, as to what sort of form regulatory intervention would take? I would seek from you an elaboration as to your thinking as to why you think that would be a better decision-making process.

MS WALSH: I'm not quite sure how to put this. In general, we think that the coverage criteria as they currently stand are appropriate. We notice that you have made some suggestions, which make it a lot more subjective than it would be at the moment. I guess the point about the NCC deciding which form of regulation should apply, that's made in the context of if anyone is to make that decision it should probably be the NCC. I guess, to the extent of your comment, we hadn't really perceived it in that way and it raises an interesting point.

MR HARVEY: I guess our view, which we made in our initial submission, is that there should be no changes to the coverage criteria and we are really just staying with that. We can't see a need for any changes. The changes recommended, particularly to criteria A, do make it more difficult and we can't see the reason for that. We are concerned that the circuit-breaker seems to be that if there is a pipeline that is not covered and someone requires access, then they negotiate with the pipeliner. If they can't reach agreement, then they simply go to the NCC. They apply for coverage. That's not practical. That's going to take years and the economic imperative would be lost by then. So we believe that criteria should be relatively simple and we can't see justification to make it more difficult than it already is.

MR HINTON: Sure, John, I understand that. In fact, we would endorse having very clear - bring clarity to criteria and how they're applied if a regulator is going to make a decision. So I don't think we have a difference there. It's to do with the two-tiered approach to the regulatory intervention that I'm seeking to explore with you. We can argue about the nuances of "material" and "substantial", as to the basic coverage test, and we have to intersect appropriately with Part IIIA outcomes there as well, the review of Part IIIA outcomes, down the track if you've got coverage, but there is still to be a decision, a separate decision perhaps by the same entity, the NCC, as to whether or not under coverage you would be subject to monitoring or

subject to cost based price regulation. What is the basis of that second separate decision? We have put forward an approach, a criterion based approach, but I was really exploring with you - you seem to be rejecting a criteria based approach. You just say, "Give NCC discretion." Doesn't there need to be a system for delineating when monitoring would apply and when cost based price regulation would apply?

MS WALSH: Yes. I mean, I'm not sure if what we're saying is that the NCC should have an absolute discretion to do that. Clearly, there needs to be guidelines as to what the NCC should, or should not, take into account when making that decision. In our view we believe it's the NCC that should ultimately make that decision in any event and not the regulator in the relevant jurisdiction, for example. But we don't think it should just be an absolute discretion with no guidelines attached whatsoever, particularly with the introduction of the subjectiveness into the coverage criteria that has been proposed, and I think it's arguable they are a bit more subjective than they were. Clearly, it would make a mockery of that really, at the end of the day.

MR HINTON: We will work hard at trying to bring greater clarity and subjectivity to these criteria. Let's move onto monitoring then, because you've made some interesting comments on monitoring as well, the regime that might operate. As a sort of preamble, let me pick up your references to the airport experience. Let me suggest some caution in reading too much into direct number comparisons as to what prices pre and post monitoring. The circumstance there is that maybe the starting point was so distorted as to transparent efficient based pricing that they had to move in some way quite significantly to get back to what could be sustainable longer term, without cross-subsidy for example.

Secondly, relevant to that in a public policy context, governments have decided not to reactivate regulation. They have continued with the monitoring regime. Not even in the light of that experience would it suggest that there have been some special factors at work. But that's a little aside and not a question. I wanted to really ask you about your two-year period. We put forward a monitoring regime having a binding ruling, when it's applied, for five years, and you suggested two would be more appropriate then five. We were driven particularly by the objective of wanting to give commercial negotiation potential to deliver and I wanted to explore with you, or get you to elaborate on your thinking, as to why you think two years would be better than five. There's nothing magical about five I hasten to add, but it's worth exploring, and an issue in itself - that if you're going to have a binding period then you've got to have some substance to underpin, whether it is two, three, four, five years or whatever.

MR HARVEY: Yes. I guess there is nothing magical about the two either. Five seemed a long period to allow commercial negotiations to us, particularly if there is no credible threat. So we came with the lower number, I guess. There wasn't a lot

of science in it. We just think that there is the prospect of the pipeliner making hay while the sun shines, knowing he's protected for five years.

MR HINTON: I've heard that expression before in some other hearings. As a sort of counterpoint though there are two forces at work here. One is that at the end of the period they can be subjected to a move from the monitoring tier to the cost based price tier that I would have thought was a powerful force to have some sort of impact upon commercial activity in that monitoring period. Secondly, there is also within the schedule of the code - and I think it's section 13 of schedule 1 - that also has requirements as to commercial behaviour. Inappropriately hindering access, for example, is directly picked up. So aren't there, therefore, characteristics of the code, plus the threat of misuse of market power changing the nature of what regulatory intervention will occur - don't they combine to bring some force to bear on effective monitoring regime?

MR HARVEY: Perhaps they could. It just seems that if we're bringing in a monitoring regime, and we say it has a minimum period of five years, then I think it will be difficult for the regulator to say, "Well, I'm not happy with what's going on and I choose to intervene." We would like to see something a bit more definite, where he can blow the whistle and say, "Right, I'm taking some action."

MR HINTON: Getting back to Cassandra's problems with regard to coverage criteria and substantial material, it does come back to, these are the cases that have already been judged not to have a certain level of market power that would warrant cost based price regulation. So it's not as if it's everybody. It's an already identified tranche of infrastructure with certain characteristics.

MR HARVEY: I accept that. That would make you think that in the majority of cases there would be no problem, but we know it's a dynamic market out there, situations do change and sometimes it takes one customer to change, or even some subsequent happening. If the pipeline gets fully compressed then you end up with a different situation. We have seen situations where pipeline owners refuse to expand the pipeline and access seekers really have no option. So I just think there's a need for a circuit-breaker, because five years is a long time if someone - well, there is a real chance of a business opportunity being lost.

DR FOLIE: But the problem lies - if you do take the point - that when the pipeline is fully compressed, the existing regime, or no regime, can actually force anybody to actually put more capacity in if they don't like the terms under which they are being offered. So that's sort of a universal paradox, which effectively you can't overcome. If you don't have that, if you have a pipeline that is underloaded and - let's say 60 or 70 per cent, so there are a number of contracts floating through that. There are a certain amount of transparencies to put broadly what the terms and conditions are.

Isn't still the commercial imperative for the service provider to actually take on more contracts?

MR HARVEY: Well, you would think so - - -

DR FOLIE: I can't see why he would want to block it, because he's trying to go for the business. Why would he not want to load his pipeline further up at something like the existing prices, adjusted for credit, short term and all the other things.

MR HARVEY: Yes - - -

DR FOLIE: It just seems to be against business sense, you know. This is the west where you do deals.

MR HARVEY: I think we can all see examples where things don't make business sense, and there's clearly political things happening in the background. However, if it does make business sense - well, let's say it doesn't make business sense for an access seeker to be offered capacity, perhaps the cost of additional compression doesn't warrant it or whatever, then we would say there would be no need for the regulator to intervene. However, consider the reverse case of that. It is a reasonable request for access. The access seeker is being denied access and he can't do much until the five-year period has expired. We would just like a circuit-breaker that could overcome that scenario.

DR FOLIE: It's on the balance of probabilities that the chances of something like that happening may be a very small probability compared to the normal, ongoing business, and is it sensible to saddle the whole business with a complex regulatory sort of system to cover the small probability - in other words, it's an insurance policy? Is the premium that the economy as a whole is paying for that insurance premium - namely, this Gas Access Regime of detailed regulation - worth it? Because it's a low-probability scenario, I think, that you're putting forward.

MR HARVEY: I think you're right. I think it is a low-probability scenario, or at least it should be, but it's like trying to foresee the future.

MS WALSH: I think also that it largely depends on the application of the lighter-handed regime that is put in place as well, and particularly how interventionist the regulator, or the responsible overseer, will be as part of that process. I think that would pay a big part as well.

MR HINTON: Let's look at some of the detailed aspects of pricing principles. We could spend another hour on this one, I suggest, but we won't. Let me be selective then. It's a challenge for us, for a number of areas of the code, where we seek

deletions, not because we have a problem with the statement in isolation. It's a question of whether an inclusion is appropriate. There are a number of examples of this in the objectives area, but also in the pricing principles. I'll come onto objectives in a minute if we've got time, but in the pricing principles you express the need to retain an explicit reference about restraining cost subsidies in the existing - - -

MR HARVEY: Yes, we do make that comment.

MR HINTON: We haven't retained it in the pricing principles. So the question is, what is your thinking behind that? Let me start off with our thinking. You're better off putting in pricing principles what they should be, rather than what they shouldn't be, in circumstances where you could have a list as long as your arm as to what it shouldn't be. Where do you stop? Pricing principles or guidelines or principles in general preferably should be a listing of positives rather than a listing of exclusions.

MR HARVEY: Yes. It is a difficult one, isn't it? I guess what we're really talking about is, does one sector of the market cross-subsidise another? I think that's really the point in discussion here. I understand that we need to be pragmatic about this but in principle we would prefer to see a user-pays situation, so that one sector does not subsidise another. In the real world there are going to be dynamics that may affect that, but that's really where - our comment comes from a principle of user pays.

MR HINTON: So that leads you to warrant explicit reference to it, as opposed to cutting it off by more generic staff pricing principles.

MR HARVEY: Perhaps we were a bit strong with our wording but, yes, we just didn't think there was a need for cross-subsidies. Let's say we wouldn't support them.

MR HINTON: I understand, but you are happy to - you support multipart tariffs, price discrimination?

MR HARVEY: Yes, we would, because we don't believe that's subsidisation.

MR HINTON: Yes.

MR HARVEY: We believe that is - well, the way we would support it - - -

MR HINTON: Commercial imperatives.

MR HARVEY: Yes, exactly.

MR HINTON: Parameters.

MR HARVEY: Yes.

MR HINTON: Okay.

DR FOLIE: But is the price discrimination just price discrimination, or is it the basis of effectively a different service, so it may be even the credit terms are quite different, the duration of the contract? Is it that sort of price discrimination, or is it just that, "I feel that that guy will pay a bit more and I'm going to charge him a bit more"? Is it, in other words, somewhat broadly service related and there may be a little bit of - - -

MR HARVEY: Yes. I don't think we go along with the principle that you charge people how much they're prepared to pay. But we certainly do think that if one party brings more to the table, then they should enjoy a lower price, whether that be security - you know, financial security or length of contract, volumes, be what it may - that's the sort of price discrimination we would support. Again, we would say that the underlying principle is user pays.

DR FOLIE: Okay, thanks.

MR HINTON: Last question, or the last area that is in relation to objectives: you baulk at some of the proposals in the draft report about deleting in the interests of trying to bring clarity to an overarching objectives clause; you object to some of the proposed deletions for section 2.24 and I think Cassandra referred to that in her remarks this morning. I won't take each in turn, such as legitimate business interests and interests of consumers and prospective users because we could spend hours on that, but rather approach it generically - that is, if you include them in section 2.24 does it really provide guidance to the regulator in how they might apply these sorts of considerations?

In the absence of saying how one takes account of users and prospective users' interests, how one takes account of legitimate business interests, then as a guidance for an objective for intervention it does seem to lack help. In fact, it may encumber rather than assist. Any reaction to that sort of proposition?

MS WALSH: I think I need to say that we would still suggest that they shouldn't be deleted from the objectives clause, but you are quite right in that if there are no guidelines specified as to how they're actually to be looked at, then I think you're right - they will encumber the regulator's decision-making process. I think it gives the potential for things to become very very bogged down and significant delays incurred as well. We wouldn't disagree with you in that regard.

MR HINTON: What have we left out in the last - - -

DR FOLIE: I've got one - - -

MR HINTON: Michael, please, that's what we've left out. Michael is going to - - -

DR FOLIE: One technical one, but it intrigues me because it goes a bit about the nature. You raised it before in your other submissions; really it's about the - in other words, there's a foundation shipper and you may, from time to time, not want to utilise that full right, and you've also got a take or pay contract in there - - -

MR HARVEY: Yes.

DR FOLIE: I'm not too sure - you've got two ways you can do this: one is you can nominate to the service provider, the main - say, "Look, I don't think I can lift so much amount from these months coming up," you can give it to somebody else and then, "I don't pay my take or pay."

MR HARVEY: Yes.

DR FOLIE: Is that the basis of what you are looking for, or are you wanting to end up as, "I've suddenly noticed somebody up there and if I change my maintenance schedule I think I should be able to then sell it to that fellow there"?

MR HARVEY: I think the answer to both those questions is yes. You enter into a long-term contract for a number of reasons, but the primary reason is that you do think you will use that capacity in the future and getting the timing right is really difficult when you're talking a long-term contract. So it may be that you have a plant expansion that you're expecting in five years' time and the five years comes around and it's now going to be another 18 months until you get the plant expansion. It would be really disappointing to find that you didn't have that capacity, so that the idea of "use it or lose it" or, let's say, unfettered confiscation, would be a major problem, I think, for us.

However, if you could trade that capacity or, let's say, agree that you don't need the capacity for a stipulated period, that would be quite reasonable. But you may well have plans already in place where you need the capacity. It seems to us that a working secondary market would solve those problems and we've done it during a shutdown. We have traded capacity on the Dampier-Bunbury pipeline and it works really quite well. I think that is the best way to do it. Whether it's for a three-week shutdown or an 18-month period during the gestation of a project, perhaps the secondary trading market could be designed to cater for both those

scenarios.

DR FOLIE: Do you have to negotiate then an access arrangement - in other words, under which that would go with the service provider and then get that certified by the regulator, or does he - because that would then be - the delivery point is going to be different and I'm just seeing - do we get ourselves into a more complex regulatory muddle? That's, if you like, the direction of my question.

MR HARVEY: Yes, I know. I think I don't have all the answers to that. I mean, the secondary trading market could become very complex and I guess we don't want three volumes written on how the nuts and bolts of it should work, but certainly in principle we've found it works quite well on a bilateral contracts basis. Now, if it was an open outcry-type market, I think it would work even better. But admittedly, there would be some need to sort out different delivery points, et cetera.

DR FOLIE: Wouldn't this work better under a monitoring regime than under a full cost of service?

MR HARVEY: Could well do, yes, and we haven't put a lot of thought into how the secondary market would work. I think an open market where people were able to see what was available - you see, at the moment you really don't know when someone else's shutdown is coming up and people can't see much advantage in advertising that, so it becomes just a matter of whether you happen to pick up that information. I think if there was a bulletin board or some sort of market where people could advertise that they have capacity available and for what term, then that would make the market more efficient.

DR FOLIE: I think you would get that, but the lighter you go and the more uncovered you go, the better chance you have of that then starting to develop, I suspect.

MR HARVEY: Yes.

DR FOLIE: Particularly in your business, in the goldfields line, we've got lots of ones that are lumpy.

MR HARVEY: Sure.

DR FOLIE: So there's a time difference. A lot of other gas pipelines don't have that same characteristic.

MR HARVEY: No, exactly right. Yes, ours probably suits a bit better, yes.

DR FOLIE: Thank you.

MR HINTON: What have we left out?

MR HARVEY: I think you might have covered everything.

MR HINTON: Let me conclude this session to record once again our appreciation for WMC Resources' participation and John and Cassandra, thank you very much for appearing today and your written submissions. It's appreciated. We know it's not costless, so thanks.

MR HARVEY: Thank you.

MS WALSH: Thanks.

MR HINTON: Give me two minutes to shift those in front of microphones and me to shift my papers around before we start the next session.

MR HINTON: Welcome back to this next session of the Productivity Commission's public hearings here in Perth on our inquiry into the Gas Access Regime. I now have pleasure in inviting the next attendees at the microphone, representatives of Alinta Gas Networks and Multinet Gas Distribution Partnership, Mr Hugh Gleeson and Mr Charles Crouch. Welcome. It's a pleasure to have you here. I invite you to set wheels in motion with an opening statement, please.

MR GLEESON: Thank you. Just to give some context first, Multinet Gas and Alinta Gas Networks have made a written submission and previously Geoff Towns and Charles have presented to that submission in some detail at the Melbourne hearing, Multinet Gas being a Melbourne based business. I wanted to come in and maybe have a second bite at the cherry but from a different perspective, to the same submission.

I'm the owners' representative and in fact the CEO of those two businesses, so I wanted to come at it not so much from the economic detail side or the detailed mechanics as has been addressed in the submission and in that previous verbal submission, but rather from the perspective of the dynamics of operating one of these businesses and from the types of services that we provide to customers and therefore leading through to how we see that the model that we're proposing enhances consumer welfare.

I suppose then, given the context in terms of the submission that we have made, in very high-level summary, it is supportive of the general thrust of the Productivity Commission draft. We've made some recommendations in some tuning that we think should happen there and explain why we think that tuning should happen. It's probably on a couple of levels. One is in terms of guidelines as to how some of these particular mechanisms work; also going down into the lower level, the bottom tier, if you like, of the multi-tiered model, the tier that exists currently in the code - suggesting how that can be enhanced.

As I say, I don't want to get into those mechanics but more talk about the overall model and how we see it's important and maybe some of the background that I give you then gives a flavour to it - what might need to go into those guidelines. The points I wanted to cover off then were looking at where we see the current regime as implemented hasn't delivered an optimal outcome; and looking then to how we think the two-tiered model can be implemented such that it does deliver a superior outcome; then talk about the specific issue that we had in our submission, the relevance of the concept of workable competition - talk about that - and then wrapping up with some implementation issues.

In terms of where we see the current regime can do better - and I don't think it's fundamentally failed. There can be lots of debate on that, but it's not a matter of

fundamental failure, it's a matter of can do better. Given that the concept, the whole micro-economic reform was about enhancing consumer welfare, improving things for the economy of the country, it has been a great success. I think it's undeniably been a great success, the reform of the energy sector - but it can do better, is really the point that we're making.

Our submission very much relates to how the regime applies to distribution. I think the practical application of distribution level is something very different to the application at transmission level. Distribution has multiple customers in terms of shippers shipping across our network, but at the end of the day it's providing gas to hundreds of thousands of end consumers. Whether we like it or not, in many cases the service that we're providing is seen by the community as an essential service, and we have to recognise that. If we don't recognise that, we're kidding ourselves. Being someone who lived through the few weeks after Longford blew up in Melbourne, I can tell you it's an essential service. Cold showers were not a lot of fun.

The model as it operates at the moment - and I say "as it operates at the moment" because I don't think it operates as it was intended to certainly by Hilmer, if I go right back to there, and probably by the authors of the code; but how it does operate really sees first of all very much a focus on price regulation. Regulators are setting out to set prices for these distribution businesses. So it's a price regulation model rather than looking at the broader price service package that gets delivered to customers. It also comes from a perspective of regulators wanting to set prices rather than the intended model where fundamentally the businesses are proposing an access arrangement and the regulators aren't testing that.

I think in practice it hasn't really been that process at all. It's been about them coming in to get that pinpoint-right answer that they seem to be seeking. That is a fundamental point of ours - that the model, in seeking a pinpoint-right answer, is really not going to deliver an optimal outcome if it's the regulator trying to find that. More, it's got to be a commercial activity in the marketplace that has to take us in the direction of where the businesses are going to provide their service offerings to their customers.

To that end we then see that what we have is a model where the regulator is standing between the business and the customers. If you ask anyone who operates in a distribution business, who drives this, who they're providing the service for, or who determines the service, what determines the service, they won't say, "The market." They won't say, "The customer." They'll say, "The regulator." The regulator is seen as the customer. He's become the surrogate for the customer and my discussions with a number of the customer lobby groups suggest that they're not happy either.

They don't think they're being well represented in the process. So the model we're talking about comes more back to putting the customer where he should be and having the regulator recognising that we are in a monopoly position and therefore we need to be constrained by some form of regulation; that the regulator then is the watchdog and applies the tests to make sure we're not operating outside the bounds of acceptability. So that's the general.

I want to give a case study. It's a case study from electricity but I think it's very relevant and paints the picture quite starkly. Coming from electricity, it's a model that's been applied in exactly the same way as the Gas Access Regime has been applied. It's actually interesting to note that it comes under a very different legislative structure with very different objectives, but the regulators, given the broad scope that they have there, have been able to make the two models identical. There's a message in that in itself.

The case study I want to talk about is United Energy - which is part of our family of companies - in Victoria. We went through a price review process back in 2000 for the period commencing 2001. It was the first price review since privatisation. There had been in Victoria only one price determination before that, and that was the gas price determination a couple of years before. But this was the first one for electricity and it was then trying to chart a way through the electricity framework that existed.

Probably a background on our company prior to that time too: United Energy probably had a bad track record since privatisation and we provided a pretty bad service to our customers, and we used to read letters to the editor every day about what a lousy job we'd done and it probably culminated when we put a football match - it wasn't actually our fault in this case, but the football match found itself in darkness and had to be continued the next day and that sort of brought the whole thing to a head, when the lights went out at Waverley Park.

MR HINTON: What year was that?

MR GLEESON: That was back in 1998. That was a big turnaround for us. We had to make some fundamental changes and we made a substantial culture shift in the company. We realised that the concept of being a monopolist wasn't total. You can't do what you like. We could not get away with doing what we liked. The tonne of bricks was about to come down on us, so we needed to respond to that; so that's what we did. We went and put a number of programs in place to turn things around. That gives the context.

Come the price review: we built on that and we'd really made a cultural

change in the company. We went out and we talked to the customers. We surveyed the customers. We talked to the customer lobby groups. We said, "Tell us what you want." We had quite lengthy discussions with them. We engaged some people to help in that process, who knew these areas well. We ended up with a submission that we put in to this price review, where the regulator had asked us to fill in a bunch of forms to tell us what all our costs were and gave us very extensive spreadsheet schedules that we had to fill in to give our costs so he could set our prices.

We came back and said, "We'll fill in your forms, and that's one option. But we've got another option. We've got what we call our customer value submission, which came out of that proposal and that interaction with the customers." I think we had a modest cut in prices, but for no substantial cut in prices because we saw that the regulator was probably out to cut our prices substantially - we would offer a package, a total package deal. I've got some copies here that I can give to the Commission just of the collateral that went with that to paint this picture, but I'll briefly read through the sorts of things that were in that.

We had a hardship policy, essential service issues; realised that there were a lot of social issues associated with the essential service. We talked to the welfare agencies, these sorts of things, and we actually built a hardship policy for end customers. We had a pensioner rebate scheme. We had enhanced reliability of supply because we'd clearly got the message back from the customer groups that they were concerned about the reliability of their electricity supply. We put in guaranteed service levels that said if certain things went wrong, if we didn't meet appointment times, if they had more than so many outages, we'd rebate them so many dollars.

We had environmental initiatives, a $60 million program for undergrounding of overhead lines, which has always been a very topical debate. We had energy efficiency programs and we had a program for interval meters which is something that's again a hot debate in electricity about a way of gaining efficiency. So we had a whole suite of these things, and that was the package deal. The result of that was that it was rejected fairly much out of hand by the regulator. There were a couple of things that they picked up on and said, "Well, we're the regulator. We like those things. We'll mandate that you do those and we'll set the price." So they picked the eyes out of it; they took those.

Some of the things - which floored a number of people, things such as the undergrounding program - they rejected because their problem with it was that they felt they had to make a decision on it and pick the right answer. There are equity issues that come into those sorts of things, and they had to get the pinpoint-right answer and it was too hard for them to make that decision. The smart metering one is interesting, because this was back in 2000 when this happened and they rejected it

in March 2000. They saw that the interval meters were the high moral ground and now they've been working on it for four years and in the last two weeks they've finally come out with a proposal to actually implement things. So we could have done it at the time in our proposed type model, but because they were trying to make the decision themselves, they had to get the perfect answer that balanced everything up and it's taken them four years to do it.

It was rejected. They then set prices and we ended up with, I think, a 9 per cent price cut. Now, they saw us as trying to bribe the customers and if bribing the customers means going out and finding what they want and then offering to provide it for them and wanting to make some money along the way - we undeniably wanted to make some money for our shareholders. We thought we'd come up with a win-win. We thought we had a line - our drivers with the customers' drivers. It's much better to align the drivers and get the win-win than to be in this tug of war that we normally have where, short-term view, we want higher prices, the regulator wants lower prices.

We reckon that's not a fun place to be, so that's why we went out and did it a different way. As I say, it was rejected. It was seen as we were bribing the customers. Depending on your definition of that, maybe we were. But we unashamedly said we were out there trying to provide what the customers wanted. So that's really the case study. When we talk to the people from the regulator's office now - and I don't want to misquote them but my general understanding of how people view that example and that type of model now is probably still similar to what it was when it happened a few years ago.

It's a matter of, "Well, if you want to provide these additional services to the customers, if you want to do these things, put them up in front of us and we'll review it. If they're good things, they'll get up, there's no problem," is the sort of response. In saying that, I think they're missing the point, because the point is that we actually had a culture change in our company that had people wanting to service the customer rather than service the regulator, and they had some innovative ideas. They engaged with the customers. The world is about evolving that and coming up with more innovative ideas and more engagement.

Since that's been rejected, we don't have those sorts of people in the company any more. We've got customer interaction people but we don't have the bright, entrepreneurial people because what they put up got knocked back, and they've moved on to places where they can make a difference. They're not going to sit around for five years and wait for the regulator to tell us what we have to do next. So we haven't actually got the infrastructure or the culture in place any more. It's gradually eroded. We've tried to hold onto it but it's gradually eroded and we don't have that culture there that can actually generate the new ideas, the next round of

ideas.

So the concept of the regulators, "Well, you tell us what you want in your package and we'll consider it," doesn't actually work, particularly as some of the innovative ideas - as I said, "Well, we'll let you do that and we'll give you the cost. No profit, just the cost of doing it." At the end of the day we're taking on risk and we're just getting our direct costs for it, because that's what the building block model does, unless we're building a big capital asset. It doesn't actually give us any profit.

We're not going to want to do that. We're not going to want to go there any more and the next price review we went through was our last gas access arrangement and we didn't go down that path because we knew that the model wouldn't cope with it. We're really saying that there's an opportunity here to have a model which then stimulates that interaction and thinks of this not just as a price determination process, but thinks of it as a price service package process that is then driving more dynamic efficiency. Dynamic efficiency not just on the front of cost efficiency, but on the front of better service provision, too.

Coming back, how does that then fit into the model here? We see the two-tiered model with the price monitoring model as the top tier of the two tiers. It is something that then is consistent with this. Probably one of the other things - if I can go back - where the model fell down with the regulator, too, is that they had to make the decisions. They had to decide whether interval meters were the right thing, whether undergrounding was the right thing.

Now, for us as a private company, we can put that forward and we can do that, as BHP can take on corporate citizen roles and governments don't have to make decisions. We can do it. If the test is: is it inside the envelope of acceptability or is it outside, there are no doubts that those things were not outside the envelope of acceptability; they were inside. It easily passes the test. We have taken the initiative and you get on with it.

Where the regulator had to make the pinpoint right decision, it was going to take four years of deliberation to get there. Similarly on the price, he was about a view that the price could not have any rent in it at all and therefore had to come down to the perfect right number. Pages and pages and pages have been written on calculating the cost of capital to try and get that pinpoint right number and that's where the focus was and you employ your bid at BHP to go and do all that stuff and make all those presentations, rather than thinking about what you can do for the customers.

You then take this back to the models as being currently proposed and if the model has a price monitoring tier which allows the company to not be scrutinised

down to the last cent, but allows them to operate in a fair environment - but that fair environment has got an envelope of acceptability to it rather than the pinpoint answer - and in fact it has tests in there that are testing against how we have - to the extent we may have abused our monopoly power, the monopoly power is not just a pricing thing, it's a service thing as well. It's in the guidelines that fit around that test that then determine which tier you sit on that then starts to create an incentive to actually provide the service.

We know that monopolists don't per se, if they are in a pure monopoly - and as I said in my earlier example, you're never quite in a pure monopoly because a ton of bricks will come down on you somewhere - but if you're in a pure monopoly you think you don't have to provide good service. But what is needed is incentives to provide good service and it's those guidelines that determine which tier you're in can actually can provide those incentives and linking back to the fundamental principles of monopoly power. We see that the model is quite consistent. As I said there that anecdote starts to give some help to how one would then form those guidelines. It's that test as to where you sit that becomes the key thing in here. That was really the picture, in a broad sense.

I suppose, just giving some gas examples, to move from my electricity case study to the sorts of things that then become important from the customer perspective and gas - and this is my view today but it really gets determined by going out and actually talking to customers over time, because their views will change over time. Fundamentally, up-front breaking down the monopolist culture that exists in many utilities - and probably ours to a fair extent - is a big starting point. I'm sure if you talk to the customers and certainly the big users, if they can see that breaking down there and they feel that they've got a bit more clout in the game, then they will certainly recognise that particular issue. Again the clout comes in because it's their satisfaction with the way we've exercised our position that then had a big determinate on that test as to which tier you're sitting in there, so that gives everyone a bit of clout in the game.

In our business in Multinet Gas, for instance, we are currently in the process of upgrading the very old parts of our network. Over the next five years we're re-laying 500 kilometres of mains - that's a hell of a lot of mains. That's going past tens of thousands, or hundreds of thousands of houses, and it has got our blokes out there tramping on their daisies, digging up their front lawns, digging up the nature strip and all those customers that are being passed by these pipes will certainly have a view as to the customer service culture of the people that are out there treading on their daisies. Getting that driver there for providing good service becomes very valuable to the customers in those circumstances.

Again, you have still got the opportunity for things such as hardship schemes,

those sorts of things, so picking up on the essential service nature. There are drivers for actually getting gas into areas that didn't exist before. I was interested in the discussion before about cross-subsidies. Getting gas to new areas has typically always involved the use of cross-subsidies; it's the nature of the beast. This again becomes a social issue about actually getting gas out to the households that haven't got them and as to whether someone is prepared to go out and take the plunge to pipe the next town and that sort of thing. Again, those sorts of drivers link to the culture, they link to the customer service, they link to the fact that the community get a better leverage under this model. There are some examples there.

Another one I just wanted to touch on - and this was the last area I wanted to cover in all the discussion - was the concept of workable competition. We put in our submission - we have picked up this concept of workable competition and we see it's a very important issue. I have seen a lot of economists debate it and I've observed it from a distance and not necessarily understood it all, but I suppose the way I view it is that we're not saying this is a competitive market and it's a workably competitive market and we're debating whether it is or isn't - that's not the point. It is a monopoly service that we provide and we recognise that. The issue is, though, this concept of how the tests of what is acceptable and what's not acceptable are applied. The way the application of the code has been to date is that the regulators have set out to produce an outcome - I think I've got them right - that is consistent with competition; so not making competition happen, because it's not competition and it's not even simulating competition; it is producing an outcome which has a consistent price level and all they're trying to do is produce a price outcome, so it's getting a price consistent with that.

The model they then work from is the CAPM model, which is built around perfect competition. Again, it comes back to their 60 pages of documentation and each finding that sets out how to calculate the cost of capital; the chasing of that pinpoint right answer. In the example I gave before, that's where I think the model has broken down - this search for that signal right answer. What workable competition does, workable competition is generally accepted in the - maybe I'm going a bit far with "generally accepted" - but however you define it, we don't have perfectly competitive markets everywhere and it is accepted in the community and in the economic community that we don't have perfectly competitive markets and that's not an unfair outcome.

There is a line there at a higher level where one is abusing one's market power, but it's not as soon as you move away from perfect competition; so workable competition defines that bigger envelope. The concept of workable competition is picking that up as an acceptable economic concept, where that is fair ground to be in that envelope of workable competition. If it's fair out there, then it's fair when we apply the test; when we go in and test whether the access arrangement put forward by

a utility is in fact fair or not, whether that be on the side of the services being provided or whether it be on the side of the price that they're being offered.

Workable competition is acceptable in a competitive world and, therefore, we apply that test and that is the economic underpinning to the envelope of acceptability that I talk about. There's not a concept here of trying to kid anyone that we're in a workably competitive market. It's more to create that acceptance of the envelope that I then describe and actually having a legal framework by which to then define and test that envelope. That's really where we're coming from there.

I suppose then, just to wrap up in the key messages I wanted to leave, the first is - and I've probably said it 10 times already - if we're trying to seek the pinpoint right answer, that's where we get lost, because it sends you down the path of extracting all the rent and it's actually some of that rent which is the thing that then drives the innovation; which is the headroom that you have where you actually fund your innovation. If it's down to, "We'll take all the rent out and we'll screw you down to the minimum price," then the companies just aren't going to maintain an innovative culture. They're going to strip their surplus costs out and anyone who is out there thinking outside the box is probably surplus to that and doesn't survive.

The pinpoint right answer is the thing we have got to move away from. It's workable competition that actually gives us a framework by which we can move away from and we really get to the model of "we propose". Whether it be "we propose" at the price monitoring level or when you come down to the next tier, there's still a concept of "we propose" and the regulator tests against that envelope of acceptability rather than seeking that right answer.

The last point, just to wrap it together, is that in implementing this - because we've got to actually get these guidelines that make sense, that actually give some definition but aren't prescriptive; they're not getting into spreadsheet level as this process or the regulatory process so often wants to do, but they need to give clear direction and clarity to what the principles are and then there needs to be an accountability mechanism to hold the regulatory process to that. What we have seen so far is no matter what is espoused as to what is a good idea, there is a natural tendency for the regulatory process to gravitate back to where it feels comfortable, which is spreadsheets developing prices down to the third decimal place. The only way it won't end up there - statements of intent won't stop it from going there. It's actually creating guidelines that can be applied and the regulators held accountable to, which will stop that.

I encourage the Commission, in coming up with the final recommendations, to really think about what recommendations need to go forward about putting things into legislation - if it's legislation - putting things into the code and putting things

into guidelines, which then ensure that we don't gravitate back to where we've been before. With that, I finish.

MR HINTON: Thanks, Hugh, very much for that presentation. In fact I welcomed this opportunity for you, in your words, to have a second bite of the cherry; or rather I think it's not quite a second bite, I think it's another way, another issue, or another set of issues, that I think has been very useful for you to come along here today and give us the benefit of your experience and responsibilities, so thank you. It has certainly supplemented the earlier session at other hearings with your company representatives.

I found that your thematic approach to the story - as to the incentives that drive behaviour, both in terms of culture of companies and also relationships with consumers - quite illustrative of the sorts of things that we have been struggling with, regarding the monitoring regime, so thank you for that. Right at the end there you got directly to my first question, which was the intent behind our tier for monitoring was one of light-handed trend information and seeking to avoid regulatory creep or regulatory risk of going down a track of fighting the natural tendencies for a regulator to be intrusive and why we sought in our draft report feedback on the sorts of guidelines that might be imposed to describe, define, prescribe the monitoring regime.

I welcome your comments on the issue of: should those guidelines be a positive listing - that is, what it should do - as well as a negative listing as to what the regulator shouldn't do. Do you think that would be constructive or would it be going to a too prescriptive approach to monitoring - - -

MR GLEESON: Again, I think we need to be careful that in trying to get away from detail we don't create detail to get away from it, sort of thing, and so it does need to be at high level principles. I think we provided some in our submission. I think we referred back to the airports regime, but I must admit I would probably go back and put my thinking cap on again and have a bit more of a look into it. I think we would be open to that, but one of the key things that comes out in here is in fact - that's fundamental in this - there's a lot of grey area in all this stuff. There's a little bit of black and a little bit white and there is a lot of grey area.

The onus of proof in these things - we just sort of paint a thing saying, "Well, you do this and you don't do that," but in fact how you deal in the grey area becomes the important thing. It comes down to the onus of proof. I think the key thing has to be here, that going back to the fundamental economic principles, we want a commercial - and we say competitive - but it's a commercially-driven market in this particular case and I suppose what I've tried to describe is how our people became commercial in what is fundamentally a monopoly business. That is a better outcome

than something purely driven by a regulator telling you what to do and telling you how much you are going to get paid for it.

On that basis, it's a matter of proving that the monopoly power has been abused and to therefore increase the level of regulation, rather than the test being the other way. I think that in itself - getting the onus of proof in the right direction - will be one of the biggest things in this. That's where, as I say, the onus of proof, I think, has flipped in a lot of the stuff that we've seen so far and is probably yet to be fully legally tested. That's probably one of the key issues in the test for which level you're at.

MR HINTON: One other way of looking at it is, where the judgment is made as to when misbehaviour leads you to shifting out of the tier for monitoring into the tier for cost based price regulation, the monitoring regime could actually provide you with information to reach that judgment after five years or you could have a monitoring regime that provided information that warranted you to look at that question again after five years. Certainly, the lighter-handed approach is the latter of those two, rather than the former. The first would seem to have quite significant risks of going down quite an intrusive monitoring approach. Do you think that sort of broad-brush approach might be helpful - that is, don't have information in the monitoring to make a judgment whether or not market power has been misused, but provide information that would warrant you to look at the question? Do you think that would be helpful?

MR GLEESON: I think it would. One of the issues here is whether it's reactive or proactive. To me, it needs to be reactive and there needs to be a problem that you've got to set out to solve. To that extent though, having talked a lot about the customer interaction and giving the customers a bit of clout - certainly open to not a continuous active monitoring of the customers, but certainly not a proactive sense that the customers need to be able to chip in at any point in time. They can wait for the review at that point in time and chip in there, but very open to a model that's responsive to customers chipping in if there's a problem along the way.

MR HINTON: But that would suggest - and we've discussed it this morning as well - that the monitoring approach for distribution could be nuanced differently relative to the transmission.

MR GLEESON: It may well be.

MR HINTON: The relationship to customers and the number of customers and the process of getting customer views are probably quite different.

MR GLEESON: There's got to be a recognition that a distribution business and

transmission business are very different. The transmission business - it's very often a single asset and one big up-front lump of capital and relatively low ongoing activity and a very limited number of customers. When you're dealing in the distribution business, there are two tiers of customers: there are the retailers and there are the end consumers. It is much more dynamic. There are thousands of interactions with customers each year, and there are thousands of little projects each year that actually go to enhancing or changing the network, responding to the dynamics of the network or responding to the needs of the customers. It's a more dynamic business.

MR HINTON: I'd like to take up your point about subsidies and put to you the question of which would you see as the preferred approach: one where you could have cross-subsidies by existing consumers, such that you have a common price even though the extension into that new town or the extension into those new suburbs is quite costly, or you can have an approach whereby it's subsidised or funded - is a better word - by taxpayers more generally, such that there's government intervention by payment to the service provider? Do you have a view from your perspective as to - - -

MR GLEESON: Yes, I do. If I go back to the Hilmer reforms again, it talked about governments in this thing as making their contributions very explicit and not bearing them in other mechanisms. But I suppose I see that we, as private companies, actually have an ability to go out and do some of those things more easily than government and this can be part of this. I almost see that this should evolve, in the case of a distribution business, with these essential service characteristics. It can evolve to more of a partnership-type model. You know, my fundamental objective here is getting that alignment that I talked about before, because I don't want to be in a tug of war; you don't win in tug of wars. It's to try and get as much alignment so it becomes more of the partnership.

There are times when we can actually do things that governments can't do. If you think about some of those cross-subsidies - if I go back to my case study again, we went out and talked to the existing customers as a group and we surveyed them and said, "Would you be happy if we actually gave a subsidy to these guys - - -"

MR HINTON: Yes, the hardship case.

MR GLEESON: - - - and they said, "Yes." We didn't just ask the hardship guys whether they wanted the money, we asked the other guys whether they were prepared to chip in and they said yes. Using that sort of a framework, we don't actually have to get the right answer. Government much more has to actually weigh up the equity issues here and get that perfect answer, but we can get in there and do it within a band. If we go outside the band, someone will give us a good clip and pull

us back into line and object. So there are constraints on us, but we've got a wider band to work with. It's a lower cost activity to actually get it done. The fact that we can do things and it doesn't take us four years to make the decision that it took a government mechanism to make.

MR HINTON: But funding to expand a network might not get quite the same consumer reaction.

MR GLEESON: It would depend on the circumstances; again, it depends on the level of subsidy you're talking about. But if the subsidy is small and we're talking about towns that don't have gas that are sort of part of our community, quite often you'll find that the community is quite open to that.

MR HINTON: Regional development is picked up in our terms of reference, so we need to be conscious of that particular consideration, which is behind my question.

MR GLEESON: Look, I don't see this as the answer to regional development. It's a little bit in there that can help a little bit.

MR HINTON: Yes. Also, more broadly than what you really thought you were talking about when you arrived, let me also pick up this point about a national energy regulator. When you gave the electricity illustration - and of course that raised to my mind that you've got direct responsibilities and interests that cover a lot of things - do you think there's a plus for a national energy regulator or am I taking you down a track you don't want to go?

MR GLEESON: No, I'm quite happy to go there. Yes, I do and probably on about three counts, if I can get up to three. It used to be three, and I can think of two of them off the top of my head.

MR HINTON: Everything is in threes.

MR GLEESON: Everything is in threes. Firstly, that it gives us the opportunity to rewrite the framework, and that's part of what's happening in this very process, but right across the board - this was all built up from about 1995. Before 1995 none of this stuff was here. It was unchartered territory. There were mostly - not all, but mostly - government-owned vertically and horizontally integrated utilities without separate regulations. So this has all been created in pretty quick time. There's been a fair old learning curve in that, too. When you pick the answer the first time, you don't get it right, and so this is an opportunity to go to the next generation - to the next tier of how this whole framework works - but it's pretty hard to find a catalyst to make such fundamental change to go to the next tier, so this becomes a catalyst for doing that. It's an opportunity to get a decent set of rules.

The next one is that getting consistency across the states has got to be a healthy thing. For a while there, when they talked of a single national regulator, they were actually meaning a tenth national regulator, rather than a single one. To see that they are now actually talking about eliminating a number of the state regulators is very positive and to get the common rail gauge - you know, we've all suffered from the rail gauges and the changing of the bogies at the border and all those sorts of things - to get the single rail gauge. Some of the state representatives here won't like this - just getting the economies of scale associated with the national process - we'll probably tend to get higher quality regulation out of the process than you'd get out of a state regulatory process, which doesn't have the scale of economies.

MR HINTON: The principle of subsidiarity would arise, and competitive federalism would challenge that, but we won't go to a discussion of that.

MR GLEESON: We won't go there.

DR FOLIE: Could we just go back to one that's probably an unanswerable question? Are there any elements in the code that need to be changed that we haven't picked up that would actually help drive away from this single point estimate that comes through? You made a very good point about actually every time - and even different codes end up the same way. There's a mind-set that must - is there any way that you could see that - - -

MR GLEESON: This is where I turn to Charles, because I'm not the one that - - -

DR FOLIE: It's a major issue, that it does converge to that. Is there any suggestion about how writing the rules might be done to deal with it differently?

MR CROUCH: I think to a large extent it's a matter of how the code should be interpreted that governs how far workable competition is going to be picked up in the decisions, and that's really what you're talking about - moving away from the single point estimate. We've given some thought to this quite recently. We actually lodged our revised access arrangement yesterday, in terms of trying to integrate the latest decisions into what you can do.

As I said, at a general level I think you can interpret the current code in a way that's consistent with the principles of workable competition. That's not really surprising, I suppose, because that principle emerged from an interpretation of the current code. I suppose the only area where there is a real question as to the extent you can do that is that the code - it doesn't actually say it's the only one, but it does seem to have a preference for using the CAPM model for determining your cost of capital. I think there's an argument there that that is not really consistent with

workable competition, because that gets you to more that sort of point estimate.

Having said that, the approach we've taken is that - and I think the draft report correctly identified that the CAPM actually is not capable of that degree of precision anyway, so I think in fact, regardless of the theoretical arguments, you actually tend to get a range of reasonable outcomes, which is consistent with the workable competition argument in that area. Having said that, I think there is room for improvement, as we put in our submission, to actually make it clearer how the code should be interpreted and to actually streamline it towards what, I think, it's generally agreed are the correct principles to be applied.

MR GLEESON: Could I just make a general comment there? I sort of say this at the general level because I don't have a fine working knowledge of the code, but to make something like that work - it operates in three tiers: first of all, you've got to have the underpinning principle that allows that to happen, and that comes back to workable competition and then begs the question, "Can we enhance that in some way?" We certainly don't want to lose it. "Can we enhance it in some way as to how it then gets documented in the code?"

The next layer you need is the administrative process that then says propose - and describes the test that there is a proposal by the company and there is a test by the regulator - and it only fails if it falls outside - if it fails that test. I know that's there, but I don't know how clearly it's there so: "Can that be enhanced?" The third level is the accountability mechanism that then makes the regulatory process accountable for that, and that fundamentally comes back to the merits of an appeal-type process. You've got to have those three tiers to make these things work. I sort of put that forward as the principle. I then personally haven't got the precise knowledge of the wording in the code to check those three levels against.

DR FOLIE: I'll come to another aspect, if I can, which we've had also from distribution colleagues, shall we say - in companies specifically I'm talking about, not the industry one - is very much this sort of price service offering type of thing, which sounds like the model that actually was being proposed for so-called electricity in Victoria. To make that workable and then the regulator - you'd have to change quite a few things, I would suspect, to get it in the code, because the regulator has got to really make this - he's given the right instructions. They've got to be very much on these economic-type cost related parameters.

Discussion always in industries that do have - you've said you've got monopoly power - are actually to, if you like, sedate the customers by giving them a lot of additional things which may be low cost to give but justify sort of a high price. Given he's got to regulate actually what your overall - are you giving value for money? He's then got to actually be given instructions about how to evaluate all of

those things and it becomes very difficult, because commercially he can do it as a business judgment, but when you're trying to judge whether it's justified or not it's coming from a different value system. How do you make it workable?

MR GLEESON: Again, I can't answer precisely on the wording of the code, but if you've got a principle that we propose and he tests - therefore it's up to us what we propose, and we're not just proposing price; you know, you're proposing a package. Fundamentally, when you talk about price service offering, that's what I've talked about here.

DR FOLIE: That's right, yes.

MR GLEESON: Fundamentally the same. It's allowing us to propose and him to test, so that's then given us the scope to go this way or to go that way. If you've then got that test such that you're not seeking to pinpoint the right answer, but it's around an envelope of acceptability, then again you've got the construct there that can allow this to occur. Does there need to be any more guidance or does there need to be any more culling of things in the code? I'm not quite sure, but fundamentally those key elements of the framework, where it is we genuinely propose and he genuinely tests against an envelope of acceptability - then you have got the right framework for this sort of thing to occur.

The other area where I'm then suggesting an enhancement of it, if you like, is that that level of support by the customer and how well we engage with our customers in some way is a part of the scoring system - not that I want to get into a scoring system, but is part of the test that applies to what tier you're on - is the other bit that enhances it that bit further.

DR FOLIE: And the final bracket of all of this, which becomes even more focused down, is that one would conceptually envisage, within a monitoring regime, that not only would you have basically what you spend and reliability of the network and then the prices you actually charge, et cetera, and how they move over time, but the challenge for a monitoring regime is then some measure of the quality of the service, the value for money that you're getting which would require on the part of the indicators being monitored a number of these service customer satisfaction - or dissatisfaction, should we say - requirements, probably a bit more than just access.

MR GLEESON: Yes. Some of that stuff is hard and designing that stuff is hard, but then maybe it's better to be the more reactive: is there a problem that's coming up? Is there noise coming up from the customers? Then that promotes the review type of situation, or from another perspective in terms of - you know, come to a formal review point - then we put our case forward rather than the regulator give us the forms that we've got to fill in. That's where these things break down, where you

try and predefine some of those - the spreadsheet that has to be filled in. You're never going to get it right. If we actually go out and survey our customers and someone evaluates that and we can demonstrate we've actually got a genuine survey and the customers are giving a good response, then those are the things that then support the case.

DR FOLIE: But a monitoring regime will require at least an annual return of something, with some measures, rather than at the end of the period, "We will now review you." That's not monitoring. That's really, "Go away for five years and we'll talk to you." That won't apply - - -

MR GLEESON: I suppose there can be - within that, there can be customer complaint-type measures and those sorts of things. There are ombudsmen in most regimes now - you know, measuring the amount of activity that has gone through the ombudsman and those sorts of things. In my mind there is - whilst, if you're calling it monitoring, there has got to be some proactive monitoring through filling in forms, but I suppose it's keeping that to the pretty thin sort of level, rather than letting it become the end - - -

DR FOLIE: The building blocks.

MR GLEESON: Yes, you're back to the building blocks. You just don't want to be there. Somehow we need to get it back to being - there's a little bit of a look-in but then there is a reactive-type process that then creates - it's the reactive process that really creates the incentive and it creates the drivers for the business.

DR FOLIE: Part of what we have said is not necessarily that the Commission is going to actually then, in the final report, list the sort of things being monitored. We really say that needs to be done in consultation, but certainly if you are to be monitored, there are going to have to be real monitoring things - a bit like Qantas have got to declare how long their planes are late; all these service things - public transport; there are a whole lot of these areas and it would be advantageous if the industry could turn its mind to a few of those to give us some indication because otherwise we're talking up there in the clouds all the time and it's actually when you get focused on a few things. If you want to keep it at an aggregate level which gives a very clear idea that would actually be very helpful - or, if you believe it's unworkable, then you tell us about it.

MR GLEESON: No. That's a fair point and we should go away and do some work in that area.

MR CROUCH: I think also in that area the potential for guaranteed service levels to act to fill that gap is probably something that could work because then again

you've got the tailoring to the local conditions, because networks differ from network to network and if you do get a "one size fits all" then you may well find yourself reporting on things that are just simply not an issue in a modern network, so the risk of failure is fairly small.

MR HINTON: Hugh and Charles, thank you very much again for your participation. It's much appreciated and it has been a very useful session. Thank you.

MR GLEESON: Thank you for the opportunity.

MR CROUCH: Thank you.

MR HINTON: We are going to break for lunch. We're running 15 minutes behind. I'm not going to reduce available lunchtime. I'm going to still keep it at an hour and come back at 1.45 for the two sessions in the afternoon. Thank you very much.

(Luncheon adjournment)

MR HINTON: Welcome back to this afternoon's session for the Productivity Commission's public hearings here in Perth for our inquiry into the Gas Access Regime. I'm delighted to welcome to the microphones representatives of Goldfields Gas Transmission, Mr David King, Mr Andy Wilkinson and Ms Suzy Tasnady. Over to you to get the ball rolling in terms of making some sort of statement at the start.

MR KING: Thank you for that. We'd like to make a brief summary of our submission and prefer to leave the remaining part of the session slightly open so that we can answer more questions and hopefully elaborate on any issues or concerns or questions that you have with the submission that we've made. I'd like to put up-front that GGT is a member of the APIA, as you'd expect, and had an input into the APIA's submission and support that submission and, I guess, the things that we will wish to go through today in the summary are the things that are more relevant to the submission that we made, and we understand that APIA have made their comments on their submission as well, and we had input into that.

First we would like to acknowledge and support the Commission's findings in their draft report. We believe that there should be an evolutionary change in the form and practice of economic regulation, so we welcome firstly the opportunity to speak today and make submissions, but also the draft recommendations from the review. We do have some concern, and I think it's echoed in several of the speakers this morning and certainly in the APIA's submission, that to some extent the devil is in the detail.

There are words such as "substantial, material, significant, likely to" and as we've heard this morning from lawyers, amongst others, there is a wide interpretation, or can be a wide interpretation of those specific words. We'd like to encourage the final recommendation be put in quite explicit terms and try to explain exactly what those terms are intended to mean, because in terms of drafting of the code it can be, at the final stages of drafting, skewed one way or the other and the drafting can lead to outcomes that weren't necessarily expected.

That goes on to the issue of best endeavours negotiation. We would like to see some principles encapsulated within the code and those principles should go both ways - that is, there should be some expectations on both the service provider and the user. Obviously the code is intended for the service provider, but there have been known instances of end users engaging in a bit of regulatory gaming to achieving lower costs and not engaged in what we'd consider to be best endeavours negotiations. So that should go both ways.

I think we've heard a lot about economic efficiency this morning and the use in the objectives clause. You have to ensure that that is sufficiently well defined and

agreed for the intended outcomes, but I think that's been discussed at some length during this morning and presumably at the previous sessions. We also believe it's not sufficient to merely fix the technicalities with the code; it also requires some firm guidance to be given to the regulators regarding implementation and I guess that's the somewhat difficult thing to try to encapsulate in a set of words - that there needs to be some guidance in the way the regulator would interpret the codes.

The code needed to give limited latitude for the regulators to define the nature of the important code outcomes - eg, the information disclosure requirements for monitoring purposes. It needs to be able to - I guess this goes back to the main point - give them a lot of guidance in terms of the important code outcomes, so just somehow categorising the important bits of the code that should drive the regulator's decisions.

We disagree to some extent with the diminishing of the role of the minister as a decision-maker. We agree with the draft finding 12.5, that it is a role for the minister as an elected representative of the community who should make the final decision, but we don't agree with the draft recommendation 11.2, that there should be a 21-day limit on the minister's objections to code coverage decisions. As has been demonstrated, there has been some time taken for the minister to make some decisions and it generally means that they have some concern with the recommendation from the NCC, and that process can take some time. I guess the longer it takes generally means that they're grappling with that decision and it may be that they are looking to go against what the NCC recommendation is, because there is a process of due diligence they have to go through and the minister should be allowed that due process to be able to form his own view on the NCC recommendation.

We agree with some of the other comments earlier, that the regulatory role should be separated, and I guess we go further: that the regulatory roles currently with the ACCC, that there should be an attempt to remove the confusion between the role of consumer advocate and the economic regulator. We don't have that situation necessarily in WA, with the ERA, but there has generally tended to be a consumer advocate bias - or certainly a desire to please all parties on the regulator - so that the regulator should be solely for the purposes of establishing a fair and reasonable tariff.

We touch on the issue of backdating of tariff reviews. I can see some problems with that, certainly in my role as a company director. If tariffs go up and you backdate tariffs - go up through a regulatory process - I have some concerns as to how I would actually, as a pipeline owner, invoice a customer. If that customer is a large - well, large or small mining operation that is close, on the brink, and we suddenly backdate a tariff and it goes up, and they suddenly receive a bill of some several hundred thousand dollars, what happens if that pushes them over the edge? I

mean, how do you (1) get the money from them, but also there's an issue as to whether it could push them into trading whilst insolvent and all those sorts of issues.

The issue of backdating tariffs should be seen from both sides - that the tariffs can go up and I think specifically on the goldfields, where there is a very lumpy load; we would only need to lose a few lumps, a couple of the larger loads, and that would - through the current regulatory process - result in a tariff increase, because the costs virtually stay the same, capital base virtually stays the same, so tariffs would go up. I see some concerns with being able to practically and commercially achieve a retrospective tariff increase on users of the pipeline.

Concern about the restrictions on material permitted under the section 38 appeal - we believe that should permit new information, if relevant, to be included in the section 38 appeal. There is also concern that the tier 2 or the two phases, two regimes that have been suggested - that the light-hand regime could be interpreted by the regulators to mean more about price monitoring than access monitoring, and I guess that's been a tendency and we've seen certainly in some of the submissions already talk of price monitoring rather than access monitoring. So we can see where some people's minds are focused in terms of that light-handed regime.

Those are the main points that we wish to cover. We did have a couple of things we just wished to correct, which were specific to the GGT's operations. Just in the ACIL Tasman submission we wanted to clarify that the goldfields is actually not under the code at present, it's under the state agreement, and the expansion that has occurred in the goldfields has been under the state agreement and not under the code. In the ACIL submission they quoted the fact that goldfields has been expanded under the code so we'd just like to put that correctly on the record.

The other issue for the goldfields: I think it's important to note that there was talk about competition this morning and that the only competition for gas appeared to be some people suggesting it was only coal, but we would have an issue with that. Certainly for the Goldfields, 95 per cent of the gas is used for generating electricity and there's an active electricity or electricity competitive market specifically in the Kalgoorlie area, and lower regimes of the pipeline. Diesel itself, even though the quoted numbers this morning suggest that gas would be the obvious choice, they were quoting wellhead costs of gas plus - so you've got to add on the rest of the stuff, the transpiration and the cost of amortising the cost of a lateral specific to a mine site and we are certainly finding that gas on oil competition is still very prevalent in the goldfields because of the total cost of delivering to an end-use customer. So even though the numbers appear to be quite separately apart, there is an active competition on gas against diesel. I think that's about it unless Andy or Suzy had some further comments.

MS TASNADY: I just have one.

MR WILKINSON: I was just going to raise the comment that a central theme that I think we're hearing is the need for guidance, regulatory guidance, and that one of the responses we hear from regulatory agencies, I guess, is that some of those issues are to do with best practice regulation and the need for independence from ministerial intervention and those sorts of issues. One of the things I'd like to do is just contrast that against the commercial situation, if you like, where in the world of commerce the people recognise the need for diversity, everywhere from the corporate governance of the board level down through the multidisciplinary project team, and recognise the advantages of that.

Yet what we see with the regulatory environment is a monoculture of economic rationalism, combined with an almost lack of accountability. The accountability is there and this is something else that's been borne out by some of the submissions - is it rests in the rights of appeal. But what we see there is that regulators act - have a strong reluctance to accept the outcomes of those appeals and instead put a lot of effort into reinterpreting them, so realigned with their original intentions, so that what gets described as best practice regulation wouldn't meet the commercial criteria for best practice behaviour.

MS TASNADY: The point I wanted to just elaborate - that David raised about the objects clause - is that we support similar arguments that Epic put forward this morning, to retain the section 2.4 factors within the objects clause, rather than having those eliminated or removed.

MR HINTON: Thank you very much for those comments from David, Andy and Suzy. They are appreciated. Thank you also for your submission. It's important - and also your involvement through APIA as well, of course. That's a significant involvement in this inquiry and it is appreciated, and certainly your particular commercial activities bring a particular perspective as well and it's important we hear from you. We appreciate that involvement is not costless.

I had a couple of queries. I don't propose to go through the APIA submission in detail, or even your own, but I had a couple of comments and a couple of queries I want to explore with you this afternoon. I think, David, your reference to 11.2 recommendation about 21 days, where it's by default and absence of a decision is a decision. We are revisiting that issue. In fact, it may be a legal question as to how can you have a ministerial decision by default, and if it's subject to a judicial or quasi judicial appeal process, then it does raise questions as to the status of the decision, among other things, but we take on board your point.

Backdating: I also wanted to react when I heard your particular practical

concerns concerning that. We certainly are revisiting that as well. We thought that there may be some benefits in having flexibility for the administrator to - the regulator - to bring to bear to his table some power to remove incentives to game play or at least reduce incentives to game play by delaying decisions that might therefore bring a particular commercial advantage. The benefits of that have to be weighed against the costs of that; the regulatory uncertainty associated with backdating. We are appreciative of your particular coalface experience as to how backdating might impact on commercial activity.

MR KING: I think that goes towards a general mentality of the regulatory processes, that the tariffs have always come down, and that's not always going to be the case. Tariffs in the future have a likelihood to go back up again and the issue there is that the users will then be the ones that potentially gain from that, and delay the process, and they will benefit from not backdating, but I just see the practical issues of backdating as - - -

MR HINTON: If you're going to have a removed or reduced incentive, then it's important that there be symmetry, but if symmetry would have even greater problems of how you charge backdated to higher prices - well, how would you go about it? So thank you for those comments.

ACIL Tasman: I appreciate your comments there. That correction is not unimportant, but it probably wouldn't change their bottom line, but we'll be looking at those numbers as well. How persuasive they are is another matter.

Andy's comment about eco-rationalism and regulators: I think a number of eco-rats probably groaned when they heard that. Most eco-rats would be quite uncomfortable with association with regulators, in terms of mind-set and responsibilities, but that's more of a semi-humorous aside rather than a substantive question or comment.

What I would like to do is start off with a question with regard to transmission and distribution. In your experiences, are you comfortable with our basic conclusions about a single Gas Access Regime covering the gas sector, covering both transmission and distribution, albeit, as we hear this morning, there are clearly acknowledged significant differences between distribution and transmission both with regard to relations with customers, but also in terms of market power.

MR KING: As we heard this morning from the distribution side of the business, the one submission this morning that was talked to, there's a substantial difference between the distribution and transmission side of the businesses. Obviously distributions appear to at least recognise that they do have some monopoly characteristics and certainly on the transmission side we are still of the view, as heard

earlier this morning, that it's a very commercial-type operation. It's the pipeline service provider and a small number of customers who do have some market power. There are smaller users that potentially don't have that market power, but the majority of the users have a large amount of market power. They are the big end of town, the big users; we're not talking about hundreds and thousands of mums or dads, we're talking about just a few industrial companies or gas traders, retailers - so there is quite a difference between transmission and distribution assets.

Certainly our initial view is that separation of the two areas into two separate codes was probably a better way of addressing the issues, or the differences between the two. But the way that it has been outlined in the draft recommendation is that it is a changing of a tier-type operation, which may be another way of addressing those sorts of issues where you do have a pseudo-competitive pipeline or whatever, that can be regulated by a less heavy-handed regulation.

MS TASNADY: To the extent that the separation may be highlighted, it could be potentially under a monitoring regime what requirements would be made for a distribution system to provide information, versus a transmission pipeline. There might difficulties in trying to make that uniform. I'm not suggesting that there should be. I'm saying if there is a situation where you've got a monitoring regime for a distribution system, their reporting requirements might be different than for a transmission pipeline.

MR HINTON: I'm glad you raised the monitoring regime. That was an area I was going to explore with you. Certainly - - -

MR WILKINSON: Sorry, Tony, can I make a point, too, on that subject before we move on?

MR HINTON: Certainly, please.

MR WILKINSON: Just the other issue that kind of relates to what we were talking about before lunch on the monitoring, or what was being talked about - was in terms of the ability to capacity trade and how that sort of can work. Obviously in a more diverse market that's easier to facilitate, so in some ways you could argue that distribution - to the extent that that may be valid at all in that scenario - is easier to accommodate within the diverse distributions type of market, compared to a transmission market.

The other issue that comes to mind in terms of differentiation, is that because of the nature of the market and that diversification, it's the sort of investment risk you're looking at and I guess it also relates to the capital profile, the investment profile, required. That's something that we haven't seen an adequate distinction in,

in allowable rates of return under the heavy-handed option that has existed to date. I think it's another area where there would be a need for guidance to let regulators know these are fundamentally different organisms.

DR FOLIE: Could I just follow on from that, because it is a part of the question I had this morning - that is, the current, if you like, cost based regulatory regime, if there is a desire - in other words, if there is latent desire that was raised by a particular user of the facility managed for capacity - even though it's embryonic, it is one of the objectives to actually get more efficient use to get it going. Does the cost based regime - can you see it making it difficult and what you have raised - you might say you would be arguing there might be a different WACC and things like that. I can just see the administration of temporary trades and swaps and things within the thing, because you may make more money out of it - there is nothing wrong with that, but then that raises the question: is that money then counted against the money you've made elsewhere, which would then lower the whole tariff system? Do you see problems? Are there barriers with the cost based thing inhibiting this particular emergence of this regime?

MR KING: Obviously I think trading should be encouraged. If it's customer-on-customer trading, where they obviously do the deal between themselves, it has no impact on the pipeline in terms of the revenue it makes, but if the pipeline is actually aggregating that unused capacity and then selling it on, then obviously that could mean some additional revenue. With a very heavy-handed regulation and the cost setting, there could be a disincentive to do that, because of - not a disincentive, but not enough incentive to do that, because as you say the regulator just comes back in and says, "You've got a certain amount of trading," or "You've got a certain amount of interruptible capacity that you have utilised to on-sell, and we're going to reduce the tariff corresponding to that sort of trading."

DR FOLIE: But doesn't it get more complex? We're probably mentally thinking about the bottom end of the line, maybe the one relinquishing to up end - the hypothetical, if it's further up the line and has surplus, then the bottom of the line wants to, then the contract has got to be the existing contract plus a bit more transport added onto it so there is, if you like, an access to the pipeline for the last sort of 300 kilometres, which wasn't in the original contract. I'm making it deliberately technical, because it is actually the nature of the regime. You've got to address that detailed issue, do you?

MR KING: It does raise an issue because Goldfields is one of the pipes that does have off-takes all the way along its length, right from the start - a few hundred kilometres from the start right to the very end at 1400 kilometres. The way that that's managed by the goldfields is actually taking the capacity back to a terajoule/kilometre-type basis. If you've got 10 terajoules at 500 kilometres it's only

three and a half terajoules at 1500 kilometres so it does actually help to - it's not a straight one-for-one trading in terms of quantities; it's actually taken back to something that's closer to the capacity constraints on the pipeline. It could be that you have more compression at the front and less at the back, so it can cause problems in that respect, yes.

DR FOLIE: Given that detail, which is what I expected, do you have to then justify to the regulator why you do that? In other words, is that an element? In other words, is it between review periods where suddenly a number of these trades - and in the end you may decide it's just not worth doing it?

MR KING: To some extent. Anything you do that goes to increase revenue - if you do that the regulator is likely to look at that as a continuing revenue source and he will then ascribe that to your revenue and reduce the tariff correspondingly, so we always like to be flexible and do business and have people - capacity trade. It's less of an incentive if the regulator is going to come back and take that from you in the next regulatory period.

DR FOLIE: Okay, thanks.

MR HINTON: Under monitoring, you have referred to this distinction between access monitoring and price monitoring. In the draft report, we deliberately, consciously, did not use the term "price monitoring" and we were rather disappointed to see, as you've rightly flagged, that a number of submissions came back to us using that expression, that terminology of "price monitoring". We see monitoring as being behavioural. How we might do that is another matter, which we'll get on to in a minute, but I assume that your use of the term "access monitoring" is the same thing as what we had in mind - that is, behavioural monitoring generally and not price monitoring. Am I putting words in your mouth?

MR KING: No, that's exactly what our comments were aimed at, that we saw access as if there was a dispute or - the ability for people to get access to the pipeline and negotiate a tariff, but the main thing is access to the pipeline. It does show a risk or maybe a warning that we talked about earlier, that we need to put explicit language in these things because there tends to be a bias and when things start to get put into a code things are read in different ways and, as you say, access monitoring suddenly becomes price monitoring and then you're in a more of a heavy-handed type of regulatory regime.

MR HINTON: In that same area of monitoring, you also express concern about the NCC being involved, as put forward in our draft report, in the shaping of the guidelines for the monitoring variables, the operations of the - the parameters for the monitoring function. This may be a reflection of us not explaining ourselves well,

but what is the source of your concern about that suggestion, the NCC having this role?

MR KING: It was discussed this morning that the NCC may have the decision - if they have the decision on the coverage issue, albeit presumably through the minister, when they start reviewing and rewriting the rules I guess they are then the policy-maker and the policy-enforcer. I don't know, Andy, if you have any comments on that.

MR WILKINSON: I think that partly our wording in the submission comes from not clearly understanding what you were intending, I think, from what we've heard this morning. I guess there's also an element of that separation of roles between - we pretty much put the NCC in the same bucket as being one of the regulators, because the attitudes and the biases expressed by the NCC are very clearly aligned with the same thing we hear collectively from the rest of the regulators, so we would have concerns about them having that ability to start imposing the sort of information requirements possibly that we're trying to move away from; maybe it's a confidence issue.

MR HINTON: Except that you're clearly endorsing the view that the regulator administering either the monitoring or the cost based price regulation certainly shouldn't be the entity making the coverage decisions. That's in our recommendations. NCC are different to ACCC, for example. But in terms of the guidelines for the monitoring approach, we would hope that under our proposals - we may need to make it clearer - they are decided in advance of the revised Gas Access Regime coming into play; we saw the NCC contributing to that establishing of those guidelines in advance, as an existing regulatory body that could coordinate consultation with all interested parties to refine, define and structure a set of guidelines and once, having got them, the system then operates with the coverage decision being made.

MR WILKINSON: That was one of our misunderstandings, in that we saw that being on a case-by-case basis, the way we read it.

MR HINTON: Okay.

MR WILKINSON: But even so, as was suggested this morning, I think it was during the Epic presentation, there is still some concern about the NCC's role in that, and that perhaps - I think it was suggested that perhaps the Commission could, in its final recommendations, include some guidelines in there of what they think should actually be included in those requirements and the nature of the limitations put on it, because that's the regulatory creep issue that sneaks back in there that gives us concern.

MR HINTON: You've got some good suggestions, have you, to guide us on that?

MR WILKINSON: It's an area we need to do more work on.

MR HINTON: Thanks, Andy. On the area of coverage we have this issue of intersection with the operations of the general access regime under Part IIIA of the Trade Practices Act. There is a concern that if you have a monitoring regime with about the same threshold as where Part IIIA can get activated, and then a higher threshold for cost based price regulation, then clearly the cost based price regulation regime doesn't operate in conjunction with Part IIIA because it would be deemed, like now, to be effective consistent with competition principles and therefore it's excluded from operations of potential activation of Part IIIA. But for those in the monitoring regime, if they have the same threshold as Part IIIA, but a lower threshold than that which relates to cost based price regulation, there's a concern that those that are being monitored could still be subject to Part IIIA negotiate-arbitrate formulation. Would you be concerned with that possibility?

MR WILKINSON: I'm not sure that's the spin that we've actually put on it in terms of the negotiate-arbitrate model that we've generally talked about. We haven't really put it in the context of being under the Trade Practices Act. It's more the commercial concept of negotiate-arbitrate, and that's what we've been talking about. I'm not quite sure how that aligns with what's in the Trade Practices Act and where that distinction lies. I don't think we've actually looked at it in that way at all.

MR HINTON: It's partly to do with the issue of forum shopping, and at the moment the Gas Access Regime in effect has primacy because the NCC certifies the Gas Access Regime as effective, but they mightn't be able to certify it effective for that tranche that relates to monitoring only, because under monitoring as described in the draft report it has no guaranteed access and no arbitration dispute resolution mechanism because it's a five-year period of you being monitored, full stop, though with an access policy being a requirement on the service provider - to put out an access policy. Therefore, we need to revisit how Part IIIA intersects with a revised Gas Access Regime as constructed in the draft report.

MR WILKINSON: I find it an interesting concept that you can have pipelines covered under the code and pipelines not covered under the code, and that doesn't threaten the effectiveness of the regime. But if you have the safety net of people who don't really warrant full coverage but can be monitored, then all of a sudden the effectiveness of the regime comes into question. To me, adding the safety net all of a sudden makes it come unravelled and the logic doesn't seem sound.

MR HINTON: We're seeking to address that, in effect, a legal issue that needs to

be addressed, which we'll be doing. So that led to the prior question: do we agree that it's important that if you're under monitoring you should not have the potential for them to be subjected to a Part IIIA negotiate-arbitrate function?

MS TASNADY: Are you suggesting that the monitoring regime would therefore have a requirement like in the negotiate-arbitrate where you have a right of access included in the monitoring?

MR HINTON: No. Rather than change the nature of the monitoring regime, which we think is important that it be light-handed and stay right away from similarities with the building block cost based price regulation, we would rather address it at source, which is look at how Part IIIA operates, such that it does not apply, cannot be activated for all those infrastructures subject to coverage. That's what our current thinking is.

MS TASNADY: I think that we'd support that.

MR KING: We would certainly support that. If you have an access monitoring regime in place, then you wouldn't want to be subject to coverage under the Trade Practices Act, and I guess maybe that is - I'm not sure what the mechanism for fixing that up is - changing the Trade Practices Act or - - -

MR HINTON: We can be creative there. We hope that.

MR WILKINSON: One of the considerations there, and I'm not really sure how it ties in in any formal sense, is the code of conduct that I think most service providers are sort of looking at supporting - we're looking at through APIA - and one of the principles there is in regard to providing the rights to arbitrate for users, but it's seen as being a voluntary proposal in the concept of it is good commercial practice as opposed to - - -

MR HINTON: Andy, that's a very good point you make because the description of our monitoring regime in the draft report has flexibility. It's non-regulator imposed behaviour, such that it's open for the service provider - while being required to have an access policy, nevertheless can have codes of conduct, codes of behaviour that contain whatever they wish it to contain. The onus is not a regulator obligation. It's up to them, the service provider, to be creative as they see fit in terms of scope that we would see important for commercial negotiation to be the sort of basic characteristic of those being monitored. Let the commercial negotiation get under way. If the service provider thinks codes of conduct through APIA are important, then good.

MR KING: Certainly, as Andy said, the APIA is considering a code of conduct,

and I don't know whether that code of conduct would be sufficient in terms of its requirement to engage in arbitration - would be enough to get around the Trade Practices Act - or whether that would need to be something else that went on top of that in terms of a change of the Trade Practices Act to excise that part of the regime from its control.

MR HINTON: There are a number of aspects of criteria for effectiveness, including dispute resolution but also guaranteed access. We would be uncomfortable with adding to the characteristics of the monitoring regime that carried with it dispute resolution, because then you have to set up criteria, institutional arrangements, and all of a sudden you're going down this track of the other tier, which is cost based price regulation - building block approach to tariff determination and service delivery.

MS TASNADY: Picking up on Andy's point, how does the no coverage, where you have no right of access at all in any form - if you're not covered, there is no right of access potentially, so how does that - how is that?

MR HINTON: Sorry. Then Part IIIA is not operative because it doesn't pass the threshold test for Part IIIA. So where the coverage test for the Gas Code coincides with the threshold for Part IIIA, then not being covered removes the action under Part IIIA but activates what action is under the Gas Code.

MR WILKINSON: Does this bring us back to this substantial and material test thresholds again?

MR HINTON: Yes.

MR WILKINSON: Along those lines.

MR HINTON: Except, though, that material - the material one is very close to the current Part IIIA, the problem being that when we did the draft report we still hadn't had the government's final response to the Commission's review of the Part IIIA, so we weren't sure precisely when we were putting together the draft report what environment we would be working under with regard to Part IIIA. We now have the government's final response to the Commission's review of Part IIIA; we therefore have, in effect, a threshold established which we'll be looking at carefully when we look at shifting from a draft report to a final report and setting out this structure of two-tiered monitoring and cost based price regulation.

MR WILKINSON: I think it brings us back to reiterating that point about the need to be very explicit and descriptive about what those thresholds mean. We just read so many different interpretations of it and that's - you know, the term "significant"

and the term "likely to" and all the rest of it.

MR HINTON: Yes. I think there may be some advantage in coinciding the thresholds for Part IIIA and monitoring, or the basic coverage test, and then seeking to become very clear as to the provision of a higher test again, a juxtaposition against the lower test, for coverage - a higher test again for cost based price regulation being the form of intervention, even though we're looking at that.

MR WILKINSON: In the context of that threshold and in the context that we've made some of the points in regard to the view we've put towards - or about negotiate-arbitrate as a model, coming back in a commercial sort of context, one of the points we've made is that while you've got the presence, the ability for the more heavy-handed option to be there, it threatens the ability to be able to negotiate-arbitrate under the monitoring regime and to explain that - the Commission has recognised that that heavy-handed option is a sufficiently onerous threat that service providers would normally want to try and avoid having it imposed on them and it's sufficient leverage that have them behave properly.

MR HINTON: Yes.

MR WILKINSON: Users are quite capable of recognising the same thing and in a commercial sense that gives them a large lever, with the potential - and the expectation that's being developed at the moment - invoking that escalation to the heavy-handed option will always give them a lower tariff.

MR HINTON: Except there's an important factor at work here: the fact that there is a dispute between a user and a service provider is not prima facie, under a monitoring regime, automatic judgment they should be in the cost based price regulation tier. Otherwise we would be caving in to gaming. It has to be a substantive judgment by the coverage entity - the NCC at the moment - that that particular case in that five-year experience period is sufficient to warrant that heavier-handed cost based price regulation. The fact that there is no agreement in itself is not prima facie. It may be informative, it may be helpful in reaching a judgment, but it is not conclusive. If it were, then you would go down that unfortunate track of allowing game playing of the regulator.

MR WILKINSON: I guess that comes back to the concern we've seen. We've seen statements by the NCC to the effect that you don't actually have to demonstrate any benefit, any practical realisation of the benefits of coverage, for instance, as long as you create the circumstances which provide a more - that promote fertile ground for those conditions to improve competitiveness in some way.

MR HINTON: Except they say in the next sentence, or next breath, that they're not

contrary to the national interest test provides a basis by which they judge efficiency - that is, that the costs are not outweighed by the benefits; that the benefits are greater than the costs. We seek for the system to be more explicit on that point, but that's - as I say - how they apply the coverage criteria, which should take account of your concern. In theory, it should.

MR WILKINSON: I agree, in theory it should.

MR HINTON: That's why in fact being more explicit should be helpful for everybody; instead of presuming that that is how they would apply that particular criterion, that that is how they should be applying an explicit criterion regarding benefits exceeding costs for coverage.

MR KING: One of our first points is that, yes, it needs to be pretty explicit and the intent and the words, yes, are the things that could see this succeeding or not, because it could be interpreted in different ways by different biases.

MR HINTON: But I'm still not convinced that Suzy's point about the higher threshold - that is, substantial as opposed to material - can't be explained in a manner that does have judicial clarity. I can see how words in isolation "material and substantial" could be open to different interpretations that might even mean the same thing - that is, material and substantial - but in circumstances where the policy intent is to have a higher threshold and the word you use is "substantial", I would have thought that the judicial uncertainty is eroded by the explicit policy intent. It cannot be the same as material, because it is meant to be higher. I come back to, I suppose, David's point, that the clearer we are the better and the clearer that is in the documentation, the better. I suppose that's the way to go, but maybe I'm not a trained lawyer - well, I know I'm not a trained lawyer so - - -

MR WILKINSON: I think our expectation is that it needs to be written sufficiently clearly that when it goes to the trained lawyers, as it inevitably will - or the judges - they will be able to interpret it along the lines that it was originally intended and it won't be thwarted to some other meaning.

DR FOLIE: In fact many of the judgments that you are reminding us have taken place are really those judgments on the basis they've actually looked behind the code and they've actually said, "This was the intent, not something else." So there's, I believe, a certain amount of - if it's worded correctly that one can actually have some faith that the system actually does work, if they then followed the trail of intent, the policy intent for it - - -

MR KING: I think that's been demonstrated, but unfortunately it ends up, in the court decisions and the Australian Competition Tribunal decisions, not - the regulator

sees it one way until he's corrected and it tends to err on the conservative, maybe, approach and it needs - until it's corrected by the courts. But then the courts do tend to go back and look at what the intent was and, I guess, more of the case history of the use of the word and what it was supposed to mean.

MR WILKINSON: In context. It sort of comes back to our point that you - it's not sufficient just to fix the technicalities within the code, there's also that implementation guidance that's needed, and that almost amounts to a cultural shift in the people who will be implementing the regulations and, I guess, then you have to ask yourself, how normally cultural shifts are achieved and if you put the same people back with the same tools in their hand they tend to give you the same result. So, you know, that's a concern.

MR HINTON: This morning we had quite a lengthy discussion on foundation customers and foundation contracts. I would welcome your perception on this issue in circumstances where I think I put the view that as regulator intervention impacting on third parties for access can have significant impact on foundation customers and those holders of foundation contracts, therefore it's important that that relationship be recognised fully in the operations of the code. Would that formulation be something you would endorse, assuming you were there this morning?

MS TASNADY: Yes, we were.

MR KING: We were. We thought it was a very interesting discussion this morning on foundation contracts and some of the comments made are worthy of note. To summarise the Western Mining comments, it was that basically when the tariff is determined everyone should be considered as a third party, so you should consider all the foundation loads as third party loads and the regulators should then determine the tariff that's applicable to those loads, but that the foundation customers should always have a lower tariff than the third party loads, which I guess goes to show an example of the truncation of return because you can never achieve what the regulator determines to be a reasonable rate of return - and return on your capital - if a large chunk of the load is always going to be at a lesser cost than the third party determined cost so you're never going to achieve the regulator's stipulated rate of return on the capital for your asset.

We support foundation contracts and we believe they shouldn't be touched by the regulatory processes. It is a difficult issue: how to factor foundation contracts into determining a tariff that is applicable to third parties that's on top of those foundation customers. If you take the very heavy-handed approach then it's probably more equitable to have the regulator know what the terms of those contracts are rather than just describe a third party, but whatever third party tariff he determines to those contracts he should understand because certainly if those

foundation customers are paying less then it would mean that the third party tariff he determines will go up for third party loads.

It is a difficult situation and we have grappled with it in terms of a submission on the goldfields because there is certainly a large amount of third party contracts. The way that it is handled in the state agreement is the way it was described, I think, by Western Mining this morning, which is a notional tariff is ascribed to the third party contracts and then the remaining contracts are determined using that notional tariff, which is basically the same tariff that is determined for third party users. That whole concept needs to be taken into account when the regulator is determining those tariffs in the heavy-handed approach. Obviously in the lighter-handed approach, where it's more of an access regime, then it's really being able to achieve a tariff that meets the expectations of the third party users that is reasonable. The foundation customers will probably pay less because they underpin the development of the pipeline and have longer-term contracts; generally credit rating is more secure, so they probably do deserve to have a lower tariff.

MR WILKINSON: I thought they made a reasonable point for the reasons David just outlined there; that basically gives you a minimum price. The maximum countervailing power has been brought to bear to establish a price and if the pipeliner from that base and having that security wants to then take the extra entrepreneurial risk, if you like, and oversize his pipeline, such that he might be able to capture additional third party load, then there's a risk attached to that and those third parties, when they come along, can get the access and they can get it on terms that are based on the best deal that was able to be got between the foundation parties with an increment for that extra risk and maybe the deferral, if you like, of the investment until they came along, but it still gives them a good deal.

It gives them something they weren't able to otherwise access, and so you do have the differential that Western Mining referred to, where foundation customers establish a base price and third parties should probably pay something a bit more than that to get their access. Of course, there's the problem there with barriers to competition and that sort of thing, but still what you have done is facilitated those third parties coming in where they could not have done that before because, without the foundation customers, the foundation parties having established the infrastructure, it wasn't there for them to access, so there is a premium that's justifiable in my - - -

MR HINTON: There would be a number of interested parties - who we had lengthy discussions with in Adelaide, for example, and some other capital cities - that would take the view that third party customers in fact enable economies of scale to accrue and therefore that benefit of economies of scale should in fact lead to a lower price for them, relative to the foundation customers.

MR WILKINSON: I think it does - I think that's where it heads towards, but you have to get over the initial hurdle of getting the infrastructure in place, and that's where you have to protect the property rights of the parties involved in that. Eventually the market grows to a stage where sufficient growth has occurred, hopefully - and GGT is in a little bit of a unique situation there with the type of market that it serves - but generally large pipelines serving large population centres you expect to grow and, as it grows, the economies of scale kick in and you'll reach some point where you get a convergent price path, if you like, and everybody is paying the same tariff and it goes down from that point. But up to that point there is - and I am not saying it has to be that way because, in the commercial world, people give away their margins quite frequently to say, "No, I understand what my economist is telling me, but I don't think that's an equitable outcome, so I am going to charge everybody the same price. Wear the hurt for a little bit. I can roll that into my allowable returns and eventually maybe we'll just defer the time when we'll start to decline in the price path in real terms" - and factor in that way. But what was being proposed by Western Mining this morning I thought was a reasonable economic proposition, if you like.

DR FOLIE: But could I put another - the commercial world can go any way. I can now give you a reason as to why a third party could come in and actually get a lower price than the foundation customers. If you have got a pipeline that's say running at half capacity and somebody decides to build - I'll use the word an aluminium smelter because it's a word we're using over here in the West at the moment - put that on very good load factor, in other words, 100 per cent pipeline loaded virtually all the year around, and then take half of it - in other words, load factor, credit terms blue chip; no problems, it may be better than new foundation customers, and with that single loading - great load factor - it could rightly demand a lower price. It probably would make - without putting words in - it commercially sensible to do so.

MR KING: Yes, certainly. All those things are considered when you are determining a tariff on commercial grounds. It is the term of the contract and the credit support of the contract and certainly, in respect of the goldfields, we have a tariff that declines as the term increases. You have a tariff of one to five, five to six - sorry, six to 10 and 11 to 15. We do recognise the fact that a long-term contract is worth more, so there are those things that would lend you to offer a lower tariff to a particular user. But in terms of the regulatory approach of determining a third party tariff, they are basically considered to be all paying the same and non-discriminatory tariffs. The economies of scale will lead generally to a benefit for everybody as the load increases, so everybody gets the benefit of higher throughput at a lower marginal cost and that gets rolled back into their contracts in terms of the lower tariff when that's achieved.

MR HINTON: But the scenario of foundation customers ex-post and passage of time, third party access occurs under coverage, the regulator intervenes and says, "economies of scale. I'll give the new customers a lower price than X" - which activates MFN clauses - that means the overall return to the pipeline owner per unit is that much less. That then raises questions of whether or not that is going to be capable of giving a return on capital commensurate with taking the risk.

MR KING: If you consider the MFN clauses - which are probably quite common - if you take the approach of saying that everyone is going to pay the third party tariff, and that's what happens; the third party tariff rolls back into the foundation contracts - then you are at the point of having the regulated return on that asset because all of your load will be at the third party tariff and that's what the regulator will assume. The issue becomes if the foundation contracts have a lower tariff than the regulated tariff and the regulator ascribes the regulated tariff to the foundation customers and then he will always get a lesser return, and generally it's all downside risk for the pipeline owner because the foundation contract owners would generally - as has been said - have the power to be able to stipulate that MFNs are in their contracts and they wouldn't be happy customers if they were paying more than the third party load.

MR HINTON: But that scenario is the basis for one of the reasons why we concluded that the Gas Access Regime, as currently constructed, has a capacity or a tendency to distort investment, such as construct to known demand. Do you think that argument therefore does have force?

MR KING: It does, because of the way the code is - it's for new third parties, it's not retrospective. It doesn't apply to old contracts unless they specifically stipulate that they will incorporate the regulatory tariff when the regulator comes out with the tariff. The tendency is for the regulated tariff to be less than what everyone else could be paying because of the incremental costs of expansion, and that's the risk, and it would tend to - as it has been described - push people into building pipelines fit for purpose and not having any of that upside expandable capacity available, which would generally lower the cost for everybody. But if they get an unsatisfactory regulatory outcome by having a very low tariff that gets put into MFNs - via MFNs into foundation contracts they could be not even making the return the regulator gives them.

MR WILKINSON: The evidence of that is seen in terms of - I noticed the Energy Market Reform Forum put a submission on the web site yesterday and they have made a comment that it's intended that the code should move away from achieving - in terms of economic efficiency, so the overall sort of thing - if the code is intended to move away from achieving short-run marginal costing then you need to include the other objectives clauses that you were proposing to take out of the overarching considerations, which shows that at least there is a substantial lobby group of users

who are firmly of the view that the current interpretation on the code should be short-run marginal costing.

MR HINTON: They say it in their written submissions - a number of them, yes.

MR WILKINSON: Yes. That is to be seen in the context of some of the questions you were asking this morning in regard to the ACCC's response, to say, "We don't actually do that. That's not what we do. We allow you full operating cost in your cost base." It comes back to the issue that you don't make money on your operating costs. Actually I think most service providers would dispute that you get your full operating costs to start with, but then you still get cut-back on your capital and your return of capital and ultimately you get a revenue cap and whatever revenue you have got has to be split up in some way, so you may or may not get - you get margin squeezing you may or may not have enough to cover your op ex.

MR HINTON: Which is what we discussed this morning.

MR WILKINSON: Yes.

DR FOLIE: Because you are not formally covered under the code at the moment, I am just curious - - -

MS TASNADY: Yes, we are.

DR FOLIE: You are?

MR KING: We're covered under code, but we just don't have an access arrangement.

DR FOLIE: It's about the information requirements. The information requirements - and you have no ring fencing problems, do you? This is my question: under schedule A of the code, which prescribes what information the regulator can require, do you find the regulators going outside of that area or is schedule A complete or should schedule A be altered? Just while you are thinking, the proposition came up again yesterday: really in some way schedule A has been talked fairly widely but the big area where these incredibly discretionary and ongoing requirements are all coming from ring fencing - and this was from a distribution site. I've never actually been able to ask the question to a pipeliner so I'm - - -

MS TASNADY: The information requirements under schedule A is not just ring fencing.

DR FOLIE: No, it's not. It's to set the tariff effectively, is the information they

require from you.

MS TASNADY: Yes. I think the way it's - - -

DR FOLIE: The additional one - ring fencing and then another source where you can start to ignore schedule A and you can actually then use that to ask a lot of other questions. I am just curious whether you are relatively - is schedule A workable? Does it need to be changed or not? We haven't heard anything from anybody - - -

MS TASNADY: I think the information requirements listed under schedule A seem to be adequate. It's the degree of detail required within that and the follow-up in that, the initial information provided by the service provider does not seem to be accepted as being sufficient. There is a continual requirement to provide far more detail and information than is necessarily required to provide the assessment. This goes back to comments that were made by earlier presenters, as well, that the access regime, the regulators ought to be looking at assessing what the information is, not recalculating and redetermining the fine, minute detail of that. That's more the issue. If you don't do that you don't need the level of detail, the information that's being required. The actual list - I would have to reconsider what the list is but other than the key performance indicators - which I think has always been a problem, to provide information on that; the other information was relatively benign in itself. It's what happens to it and how it gets treated that is the problem.

DR FOLIE: So it might require a line item and then what you're saying is when it's provided they are saying, "How is it made up?"

MS TASNADY: Yes.

DR FOLIE: So therefore - - -

MR KING: I think it was mentioned that this pinpoint - you have to get to this pinpoint accuracy? The recent decision by the Australian Competition Tribunal, which is that they should be within the acceptable range - the comment I would have is that if you're working within an acceptable range, why do you need to know the distance of an off-take point down to a metre? That's down to four or five significant figures in a calculation and really that information is far too detailed. That offset point down to the metre - is that along the ground or is that on the length of the pipe or is that as per the construction documents?

That would change by several - it could be a hundred metres in terms of how you measure that point - but is that level of detail required if you're just looking at a range of possible outcomes, or approving a proposed access arrangement if you think it's reasonable? That level of information has required quite a lot of work to be done

by the company to produce that sort of information, such that the regulator can assess it. The range is probably there, but I guess it's just been a case of how the regulator has interpreted the requirement for the information down to the nth decimal point.

MR WILKINSON: I'd be inclined to put it to you that the level of detail routinely supplied to regulators would actually exceed what gets supplied to a purchaser of the asset. The regulators go to a level of detail below that which a purchaser of the asset would go to. I can't guarantee that, but that's my suspicion from what I've seen of both sorts of processes.

MR HINTON: Perhaps the regulator would say the objectives are different.

MR WILKINSON: But that's a prior - - -

DR FOLIE: There are many sources of data in addition to what is in schedule A. In other words, that's the bottom line, is what we're really saying.

MR HINTON: Have we left anything out that you think we should be focusing on in the available time?

MR KING: I don't think so. As we said, we generally support the thrust of the draft report.

MR WILKINSON: There was a question you raised of the distributors this morning, Multinet, in regard to the acceptability of customers cross-subsidising, say, new customers. A case in point there would be something like the Central West Pipeline. I wasn't there but my understanding of what transpired at the public forum there was that the ACCC met quite a cold reception because the local regional community was very keen to see this pipeline go ahead and they were quite prepared to wear the tariffs on the expectation that the load would grow and they just did not want to see that threatened. What they saw were people coming in from the ACCC to impose theoretically derived prices which, yes, sure, gave them a bit of a discount up-front but threatened the whole exercise. There were signs that, yes, users in certain circumstances will accept that form of - in that case maybe it's a temporal cross-subsidy - and I think that was worthwhile mentioning.

The other point was in regard to the comments fairly widely put around that the processes under the code have been a result of teething problems. It needs to be seen with the reflection - there was a notice put on the site the other day to say that the DBNGP access arrangement had been deferred for the next access arrangement period but there is still a nine-month period been given to assess and improve that access arrangement. That's nine months that has been allowed so that's not indicative of having - and that's after a further final decision, that admittedly is being

contested - but it's not really indicative of any sign that the process is getting shorter.

MR HINTON: Thanks.

MS TASNADY: I have just one question actually, about the reason regarding the section 38 and section 39 appeals process. We put in our submission that we accept the material that needs to be provided under section 39 should be allowed to be expanded, whereas in the section 38 you were proposing the material provided there should be provided prior to the appeal process. Why?

MR HINTON: No new material being added.

MS TASNADY: Yes. It was almost a reversal of each one, but why was there a restriction on the 38 but a relaxing in 39, which we support - the 39?

MR HINTON: I'd have to go back to the report to check your formulation to see whether it's describing it as we wrote it, but behind our look at this area were two aspects: that it's important to have natural justice and review processes apply to ensure that there is rigour to outcomes and that there are opportunities for challenges of decisions appropriately, but that the efficiency of that is eroded very quickly if new information can be brought at every step of the way. Sometimes reviews and appeals are efficient and effective if that which is being examined by the relevant appellant body is focused particularly on the matters that were being considered at the time of the decision. There are other forums by which new information can be examined. That basic approach underpinned our recommendations in that area but I'll go back to the words to see if we've got it as clear as it should be.

MS TASNADY: All right.

MR HINTON: Thank you very much for your attendance today and your submissions and your involvement, not only here as your company but also through APIA. Thank you. It's appreciated and it's important. We were supposed to have a 15-minute break for afternoon tea and we still will.

MR HINTON: Welcome back to this final session of the Productivity Commission's public hearings here in Perth for the Commission's inquiry into the Gas Access Regime. I've pleasure in inviting representatives of the Economic Regulation Authority - ERA - to the microphones. Welcome. What I'd like you to do for the purposes of the transcript is identify yourselves and, having done that, I'd welcome you to make some sort of introductory statement, a summary statement that might set proceedings under way.

MR KOLF: Thank you very much, Tony. Peter Kolf is my name and I'm currently the acting general manager of the Economic Regulation Authority, and I'll leave Rob to introduce himself.

MR PULLELLA: I'm Robert Pullella. I'm currently the acting director of the gas division of the Economic Regulation Authority.

MR FARRANT: Good afternoon. My name is Les Farrant and I'm with Farrant Consultancy and I'm currently engaged as adviser to the Economic Regulation Authority.

MR HINTON: Thank you very much. Over to you.

MR KOLF: If I may, by way of introduction, just thank you for the opportunity again to be able to comment on the review process that the Productivity Commission is going through. We have had the opportunity to look at the draft report and we have given consideration to those matters. As you would appreciate, though, the authority is only just on three months old, having been established on 1 January 2004. In addition, I think it's probably important to give recognition to the fact that the governing body of the authority was only really established on 8 March and therefore has only been in place for a matter of some weeks now, and therefore the body hasn't really had the opportunity to be able to itself provide input to this report, and for those reasons our submission is still in the process of being finalised.

We anticipate that we'll be able to do that within a matter a couple of weeks and therefore our responses today and the responses that we have provided in draft form are very much the views of the secretariat at this stage and, as I've indicated, we'll firm those up as being the views of the authority as quickly as we can. However, the authority is happy for us to proceed on the basis that these matters are views of the secretariat, provided that they are seen in that light and that anything we may say is subject to further clarification.

As I've indicated, we anticipate finalising our submission within possibly two weeks and, by way of a general approach that we've taken to responding to the draft report that has been issued, we do not really seek to comment on

policy-cum-political aspects of the matters that are under consideration. In particular, we do not propose to comment on coverage matters, but rather we do wish to provide input on process issues and administrative matters relating to the administration of the Gas Access Regime as it is now, and as it would be proposed, and that's done in a sincere attempt to assist the Productivity Commission in moving forward and toward achieving a better and more efficient regime in the longer term.

Now, we are happy to go through and discuss some of the key issues or present on the key issues very briefly, and we've divided that amongst ourselves. I'd like to call on Rob to just provide the initial part of that and then Les to undertake the second part.

MR HINTON: Good.

MR PULLELLA: Just to add to what Peter previously said, the secretariat has actually given consideration to the draft report and offers comments to assist the Commission in its finalisation of the report. It doesn't offer any particular view on whether an industry should be subject to access regulation or not, or on the stringency of the regulatory regime to be imposed. It's not seeking to advocate any particular outcome by the Commission. The secretariat is of the view that the findings and recommendations of the Commission should be based on proper evidence and not be unduly swayed from an objective assessment through claims by parties expressing views on matters in which they have a clear self-interest.

It is also of the view that the Commission should pay particular attention to the practicality of implementing any of the changes it is considering to recommend. Having said that, the authority considers that the primary aim of the Commission has been largely addressed. The secretariat offers comments on that focus, primarily on the matters of interpretation and implementation. On the matter of draft recommendation 5.1, which is regarding the overarching objects clause, the view of the secretariat is that if an objects clause is to be inserted, care would need to be taken to ensure that such an objects clause is consistent with the remaining wording of the regime. For example, the relevant regulator may find this clause to be in contention with other parts of the code, such as section 8.10 which, in its present form, is not constrained to the economically efficient use of or investment in pipelines.

In respect of draft recommendation 5.2, which deals with the objectives in the introduction of the Gas Code and their deletions, it is noted that the proposed deletion of related objectives B, D and E in favour of the overarching term of economic efficiency appears to significantly narrow the application of the code. Again, this raises important questions of consistency and the possible need for extensive further changes to avoid tensions between various provisions of the

regime.

In relation to draft recommendation 5.3, which deals with section 2.24, the authority recognises that the two matters that the Commission recommends to be retained are both important considerations in the assessment of proposed access arrangements - that is, respect for existing, binding contractual rights of service providers and not adversely impacting on safety and reliability. It would appear that the Commission envisages that the regulator would only consider stakeholders' interests if they are consistent with economically efficient outcomes. This may require careful consideration of other matters within the code, that may not be consistent with economically efficient objectives, to ensure that if there are conflicts the regulator has some guidance on how these may be resolved.

MR HINTON: Thank you.

MR FARRANT: Thank you. You'll note from the material which you've received that there are no comments about draft recommendations in section 6 of your report. The secretariat acting for the Economic Regulation Authority has thought that commenting about policy matters, about coverage, is not an appropriate action for this regulatory agency and therefore it doesn't do so. Therefore, you can assume that it neither endorses or doesn't endorse those recommendations. However, there are some observations about the practicality of regulators becoming involved in the alternative regime of price monitoring, which I'll cover in a series of discussions here.

MR HINTON: Good.

MR FARRANT: That picks up therefore a draft recommendation 7.1, which makes substantial amendments to section 8.1 of the code, and some observations which the secretariat would like to make on that. There's a change in the introduction to 8.1 - has shifted the weight of 8.1 on to what regulators should do rather than what people acting under the code should do, and therefore reduce the ambit of the force of 8.1. I think the Commission should consider what the force of 8.1 is on all stakeholders in this business, not just on the regulator.

With respect to guidance that the regulator received about balancing objectives when conducting his activities under section 8.1, that's also been removed and therefore the regulator now looks to have to fall back on the objects clause exclusively as to how to balance activities, or balance issues in front of him, so there's a reduction in guidance to the regulator as a consequence e. There's also a shift in 8.1 from competitive markets to generating revenue for regulated services and so the regulator seems to be becoming - making sure that the revenue derived from services meets the regulated service provider's needs, rather than trying to see

how competition is going to be implemented or the effects of competition are going to be implemented in this sort of area.

Section 8.1 contains incentives, but now it restricts incentives to cost reductions and productivity gains - and so amidst things like quality of service and promoting market growth in this particular important section 8.1 on principles - and there is a question therefore as to whether it's the intent to restrict incentive mechanisms only to those two things. There is an invitation, almost, issued in the new section 8.1 for intrusion by the regulator into the business of the service providers in terms of having to address long-run efficient costs and to make sure that at least attributable and incremental costs for each service are covered. That means a lot of information has to be in front of the regulator if he's to deliver that particular obligation.

There's a mention in 8.1 about regulatory risk, and the question in the regulator's mind arises: what does the PC have in mind about this? Is this a regulatory risk in general across all covered pipelines, a bit like the truncation premium that's proposed to apply in general across all covered pipelines, or is there to be an accommodation to particular circumstances, where the regulatory risk of being in front of an individual regulator with an individual pipeline at an individual point in time is what is involved and some adjustment to rate of return needs to reflect that? I think, in conclusion, the secretariat believes that there is going to be some need for some fairly robust guidelines and definitions to guide the regulator in its work under such a clause as 8.1.

Draft recommendation 7.2 deals with the mechanisms in the code for competitive tendering and the secretariat wishes to say that competitive tendering is okay and it may indeed have application for a price monitoring regime as well. In other words, price monitoring might be one of the tenders as put forward quite conceivably in a circumstance where regulatory arrangements are being tendered. Draft recommendation 7.3 addresses that information needs to be standardised and I think the view of regulators generally is that they can come forward with what their information needs are, and have been endeavouring to standardise those needs, and if it were necessary for regulators to become involved in standardising needs for price monitoring regimes, they could probably do that, too.

Certainly setting up the National Competition Council to set information needs on an individual basis under price monitoring seems to go counter to some of the standardisation effort because it sets up the NCC to produce individualised information requirements for individual pipelines as opposed to a standard package. There is experience coming to the regulatory area and to the pipeline industry generally of dealing with the information needs under this code and, as these arrangements now move into the revision phases, as opposed to the initiating phases

of coverage, some of those information needs are being subtly changed, partly because a huge amount of information has indeed been generated during the first run of these access arrangements and revisions simply don't need to address that same package over again. They may need to deal with different things, but certainly not the whole package again.

Draft recommendation 7.3 goes on to deal with incentive mechanisms and they are yet to demonstrate their effectiveness, but they require information too. They need people to understand what are the agreed suitable forecasts and benchmarks to be used against which you evaluate the performance under incentives. You need to be able to accept the results which are presented to you as being reasonable and therefore the incentives are worthy of recognition and carry forward, if necessary, and there are typically multi-dimensional aspects to incentives - that is, you don't just cut costs, but you might also increase the service levels at the same time - and these aspects need to be thought about changes recommended in recommendation 7.3.

Draft recommendation 7.4 covers an automatic expansion of coverage should there be expansion of a covered pipeline. The secretariat offers that if this is a coverage decision, then it might be better that the opportunity was provided to the normal decision-maker for coverage, as to whether a pipeline was going to have automatic coverage of its extensions and expansions or not. That decision might also be done at the same time the original coverage decision was thought of; in other words, the coverage decision could decide that extension expansions of that particular pipeline were going to be appropriate and make it part of the decision. or it might decide that they weren't going to be appropriate and therefore exclude them from automatically happening for that pipeline.

Draft recommendation 8.1, dealing with light-handed alternatives: again I return to the reticence of a regulator to make comments about a policy matter on coverage, but this recommendation 8.1 relies upon draft findings 7.5 and 7.6, which are about costs of the current regime as being reasons why there should be available a light-handed regime as an alternative. The secretariat offers some comments about draft finding 7.5 and 7.5 tackles whether or not further studies - usually involving consultants - are likely to reduce uncertainty when this issue is in front of a regulator. Regulators generally see the need to provide a competent and robust assessment when they're conducting their task and they are in the face of a degree of information asymmetry when they do so. Accordingly, it has been the practice to try and redress that information asymmetry by resorting to other external advice, particularly advice which may seem independent of the interests of the service provider in this. Certainly in the absence of information to the regulator there can be quite negative outcomes in terms of the regulator delaying the process until he gets the information or making decisions to deny acceptance of an access arrangement simply because he

doesn't have adequate substantiation for it.

Draft finding 7.6 highlights market impact and it's not quite clear what the Productivity Commission is seeking to do in this instance. I think the concluding remark is that the Commission shouldn't disregard the costs of implementing the price monitoring regime either. There is a significant information requirement to run an effective price monitoring regime. There will presumably be annual reporting and annual involvement of a regulator, rather than simply involvement formally on a five-year basis as might happen under an access arrangement and so we ask that the Commission consider the practicalities and the costs of the price monitoring regime, as well.

Draft recommendation 8.2 deals with the monitoring form of regulation. The question arises for the regulator: what exactly is the role that the regulator should have under a price monitoring scheme? Is it intended that the regulator be a casual observer and a reporting agent, simply making the factual information available which has been delivered to it from the service provider, or is the regulator intended at the other end of the scale to effectively be an advocate for users and prospective users in the pursuit of economic efficiency objective, which is the objective after all that has been proposed in the objects clause? If that objective is to applied to a regulator pursuing price monitoring, then the regulator would see a responsibility to do more than simply report information that is reported to it. One thing is clear: the regulator's role in price monitoring needs to be made explicitly clear under the code and authority be delivered to the regulator to deliver on that responsibility.

Draft recommendation 8.3 deals with the monitoring regime again and a recommendation that the National Competition Council should specify information that the service provider is required to disclose to the regulator. It indicates that profitability monitoring and reporting after the event is involved and this may produce little of value if there isn't an ability of the regulator or other stakeholders to evaluate that profitability against some unbiased comparisons and so yet another avenue of involvement of a regulator is opened up under price monitoring. Again the responsibilities of regulators under price monitoring needs to be specified.

Draft recommendation 8.4 gives the regulator a particular responsibility under a price monitoring regime to deal only with factual information or, should I say, to make any commentary that should be factual in nature only. The regulator may indeed have problems complying with this if there isn't some ability of the regulator to deduce what is factual and what isn't and what is relevant and what isn't and to question against guidelines for its involvement in reporting. Draft recommendation 9.1 provides for a binding ruling on coverage; in this case from the National Competition Council. Consistent with the other coverage issues that are involved under the code, the secretariat would believe that sort of decision again

should be made by an elected decision-maker, not by an advisory agency in the case of the NCC.

Draft recommendation 10.1 deals with associated contracts for services at the reference tariff and whether these should simply be notified, as opposed to authorised. The question arises for a regulator whether he's adequately informed if he simply is notified about the terms and conditions under which the associate is taking services under this associated contract. To the extent therefore that the terms and conditions need to be understood, as well as the price for an associated contract, we ask the Commission to consider the role of the regulator in becoming informed on all those aspects of an associated contract if it is only notified to it.

Draft recommendation 11.1 notes that the regulator would be only able to extend a period for approval once by two months. I don't doubt that the time taken for regulatory processes will improve as we move to revisions of access arrangements, as opposed to initial access arrangements, but certainly the time has been substantial in many cases. The improvement of that time by allowing regulators only two months' notice, however, may damage the process itself, given that regulators may not have the information they need and they take therefore decisions under time pressure rather than under knowledge.

It is suggested that backdating should be a discretion provided to a regulator - that is, backdating of reference tariffs. The secretariat believes that if backdating in fact is to be provided as a discretion, there needs to be some sensible process built around that - that is, there needs to be pre-notification of all the stakeholders that backdating has been contemplated. There needs to be a capacity for stakeholders to respond to that possibility and provide advice to the regulator before a regulator is put in a position of exercising such a discretion. In short, a better process around something.

Moving to draft recommendation 11.2, that is the regime should be amended whereby the National Competition Council's recommendation on coverage be agreed in the absence of a ministerial objection within 21 days. It's a policy issue on which the authority wishes to make no comment, other than to note that this sort of requirement on coverage decisions would be consistent with coverage decisions remaining with the minister at all times and not being diverted to advisory agencies.

Draft recommendation 11.3 is that the further final decision should be removed from the approvals process. The secretariat is of the firm view that there is value in the further final decision process under the current arrangements. The service provider gets a chance to respond to the final decision. There's an opportunity to clarify points of difference. There is an ultimate step, if you like, in draft, before the drafting of an access arrangement only as the last resort by the regulator. The

secretariat doesn't believe that the further final decision is likely to expose substantial revisions that are fundamental to the information or decision-making that was used in the final decision itself, but provides an opportunity for clarification and accommodation in some cases. It certainly allows the service provider to put before the regulator at that point any information that the service provider might think is relevant should he wish to take the matter to a merits appeal. If the Commission wishes to continue with its view that only information that has been before the regulator should be available in an appeal process on a merits base, then having the further final decision provides a great facility to the service provider to make sure that it has got information it wishes to have in that process reflected there.

Draft recommendation 11.4, regulators can specify a date by which the service provider must submit proposed amendments: the secretariat supports this proposal and thinks it was a deficiency in the code that this wasn't available from day one. 11.5 covers the limitations of the grounds of appeal and the secretariat believes that a full merits based appeal, if it comes after the regulator has drafted and approved its own access arrangement, would be an inappropriate change to the code. 11.6 deals with the scope of material before the appeal body and I have already discussed that; that the limitations of material before the appeal body is supported by the secretariat.

Finally, draft recommendation 12.1, deals with the agency responsible for making recommendations should be separate from the regulator under this code and the secretariat supports that position by the Commission. Part of the submission which you have received, which at the moment is in confidence pending a decision by the Economic Regulation Authority, contains responses to your requests for particular information on a number of items. I won't go through those now, but it's included in the submission which you now have. Thank you.

MR HINTON: Thank you very much for those comments from all three of you. The Commission appreciates the ERA's participation in this inquiry. You bring a particular perspective that is valuable and so we appreciate that input. We also acknowledge your point about the status of your submission at this stage and that's taken fully on board and we look forward to it being cleared after due process and enable us to put it on our web site for others to see, as well.

We also acknowledge your point - that you have appropriately and sensibly and very usefully focused particularly on process aspects and administration aspects. That is a particular perspective of your input here at the coalface as regulators that we value, so thank you. Your draft submission in confidence goes directly to considerable detail of the specific wordings in our findings and recommendations, in the areas in which you're bringing expertise. That's very useful for us. We like that very precise, specific and focused input, thank you.

I'm not going to use this afternoon to go into each one of those, but I'm going to select a couple of them. I particularly appreciate the reference to how pricing principles might be tidied up and refined, but also made consistent throughout the documentation of the Gas Access Regime. That is a particular challenge to an area that is probably quite potentially fruitful for refinement, with regard to the administration and application of the building block approach that clearly is a key characteristic of that part of the regime.

I want to react to a couple of points in terms of clarification - not all of them, but in terms of how you've read what's in the draft report - that I might take the opportunity to flag now, for example, the role of the NCC. I think our drafting is less than precise as it should have been with regard to coverage decisions. We're not seeking in any way to back off from the basic approach that the minister makes decisions and the NCC makes recommendations, but if you look at the wording of 9.1, I think it is, I can see how you read it that way. It will be tidied up for the final.

Similarly - and a number of others have raised this as well - in terms of the role of the NCC with regard to guidelines for the monitoring regime and how it might operate, our approach was one of recognising - and I think everyone has endorsed this that's endorsed monitoring - the importance of having clear guidelines for how the monitoring regime would operate - for example, including information that would be covered. It's important that those guidelines be prepared in consultation with those in the industry, both distribution and transmission players, but we see that being done in advance of the new revised Gas Access Regime being brought into play. Once we make our final report, that in effect is the end of the Productivity Commission's role.

We felt it important that there is a system in place to ensure that the guidelines for the monitoring regime be crafted and drafted and prescribed on a full consultative basis. We will have things in our final report that we think should be underpinning that system, but we thought it was important to have the NCC take on board that role to deliver it before the regime, as revised, gets implemented. In the circumstances, we suspect it appropriate that there may be some future changes to those in the light of experience. They usually are a living document rather than set in concrete and therefore you need to identify the entity that will have that ongoing role as well, not as if they'd be updated daily, but would be occasionally. There is perhaps a lack of clarity in our crafting and drafting there that might have led to some misunderstanding of what we particularly had in mind.

My first question is in relation to an area that hasn't been touched on in your submission or your comments this afternoon; it's in regard to what a number of parties have said to us - that it's important that any revisions to the Gas Access Regime take into account explicitly recent events, certainly some recent events post

our draft report - and in particular decisions that might have emerged either from the court case and or the ACT, the tribunal. My question is for you, as regulators: how do you think this is best done? At one extreme, you can take an ACT decision on workable competition, or an interpretation of the outcome of the Epic case, for example, and change the code itself - change the Gas Access Regime to explicitly record the interpretation of the Western Australian court on this case.

At the other extreme, the regulator has made a decision and the courts have made a judgment; from then on, the regular will take account of that in his day-to-day operations to ensure that they don't want to front the court again and once again get corrected. It's important therefore that precedence, judicial process, outcomes from judicial process be incorporated into the arrangements of approach inherent in the regulator's role. There may be variations in between those two extremes. I'd welcome your views on which you think might be the preferred way to go with regard to taking account of recent events.

MR KOLF: If I can just start off on that particular issue: clearly, as decisions are made by courts and review bodies, those decisions do get factored into further decision-making by the regulator. It's probably important to recognise, though, those decisions have key elements or key features which go to the heart of what the court decision may be about, but then there are a whole array of related issues that might be discussed by the court in coming to that key particular element. It probably raises the question: what aspect of the decision and what weight would a regulator need to give to all of the things that are actually forthcoming in one of these decisions? Certainly, the key decision or the key element of the decision by the court or the review body is one thing that a regulator would need to give considerable weight to and, in those circumstances, there is some basis for thinking, yes, this has become part of the precedence and would be associated with the interpretation of the code from thereon.

Insofar as the many other comments that are associated, but perhaps ancillary, to that key finding, what weight needs to be given to those? There actually arises quite a bit of a dilemma, in that what you may well find is that a court will have one view and a review body may actually colour those sorts of issues slightly differently. Therefore, what you find in those circumstances is that the regulator is again having to exercise discretion as to how he interprets those matters and how he brings them into consideration. What is important in all of this is that as these decisions do come out they do fill in some of the gaps around the existing piece of legislation - let's say, the code - and it does provide greater clarity and greater certainty for future decision-making. That then raises the question: what if the code were then changed to pick up on some of those issues? In doing that it raises the possibility that therein would be a risk of opening up new issues and introducing new uncertainties, depending of course on how tightly and how specifically those amendments are

introduced.

The interpretation of the code and the workings of the code is a matter that does take time, does take decisions of courts and review bodies to finally resolve and, indeed, there will always be circumstances where parties will want to have a higher level body than a regulator to finally adjudicate on the interpretation on any piece of legislation. I don't think that there's an easy way of avoiding that. The point I'm making is that, to some extent, picking up on some of the things that are put forward by courts will have some benefit, but they also risk the possibility that it will further unstabilise and further add uncertainty and the eventual outcome may not be as was desired by the party seeking those changes. I don't know whether anyone else wants to comment on that.

MR PULLELLA: If I might comment: the premise that your proposition seems to be based on is that the court necessarily understood every aspect and intent of the code as it was implemented. The court, as I understand it, actually interprets as black and white and has certain rules and parameters under which it interprets and makes decisions. There are certain words in the actual code that pointed to a particular interpretation. The court couldn't consider it within the normal context of the legislation as to economic efficiency being a primary consideration. That's correct within the letter of the law, but it's a case of what was the intent of the code. There's a fundamental question: has the court actually captured the intended objectives of the code and worked from that base? If the court's interpretation of the code and subsequent decisions made on that interpretation are on a false foundation, then there is a problem with actually perpetuating the shaky foundation on which everything then stands. That's one comment I'd like to make.

MR FARRANT: Reflecting that you're conducting a review and there's been a lot of shifting of ground, if you like, while you've been doing the review - because it's an extended process - the question must arise as to whether the review should accommodate those changes immediately as well, and reflect that the regime now is different from when the review was started. You've got an opportunity in the next couple of months to think about how you accommodate those findings of courts and appeal bodies as well.

MR HINTON: That was implicit in my question.

MR FARRANT: Yes. The expectation, I have to say, from regulators is that you will accommodate them in your recommendations in some shape or form, because they're part of the context in which regulators now operate and believe the code to function.

MR HINTON: Yes, but we could say that therefore the code needs to be changed

or the Gas Access Regime needs to be changed and we could say, "It doesn't need to be changed, because the regulators will use that as precedent, so there's no need to change it." That was my exact question.

MR FARRANT: Perhaps it might take a legal mind to get at the heart of this, but I think there are some things which may still go to appeal as specific questions, even though they've been commented upon by the appeal body, for example.

MR HINTON: Yes.

MR FARRANT: Until they're resolved as specific questions put either to a court or to an appeal body, they simply become, "That might be the view of the appeal body," depending upon how it was asked the question. That's one of the grey areas at the moment. Certainly, the specific questions which have been asked of courts and a lot of appeal bodies have been dealt with, and I believe regulators will act appropriately in those contexts, but there are some grey areas around some of those decisions which may require yet further clarification by the same mechanism. They could be clarified by simply changing the code. You might not therefore need to put some service provider through the agony and cost of taking an appeal to resolve some of that. If the purpose is to clarify the way the code works and the way regulators, in particular, work under the code, it might be better to simply grasp the nettle and change the code now, rather than rely upon appeal to fix it.

MR HINTON: You make a good point, Les. If a judicial or quasi judicial process identifies an area of lack of clarity in the regime itself, that in itself is a message to do something about it that may not be directly related to how the court or judicial process reached a conclusion on that particular issue. It may just identify an area for attention. Thank you for those comments. I was going to move on to another topic.

DR FOLIE: I've got a slightly different topic, too, reasonably general. I know that you're not commenting on the issue. We believe that it's an important role that somebody like the NCC can actually define a group that's really capable of exerting monopoly power, et cetera, and they maintain to be regulated broadly in the normal way. We then have a monitoring regime for those who are really - a certain amount of competition but not a lot, so therefore they are open to more competitive forces and don't need to be regulated in the same way. A key part of the monitoring regime, as we've discussed it in our report, is to be deliberately not detailed in the same level of forensic investigation as the other one, but they need to actually provide - and it's a performance monitoring regime, which is access plus also price. Behind our minds is a set of indicators which could be put together in advance - in other words, for everybody - that can be then monitored, watched and reported on over time.

Getting to the crux within your submission, do you feel that that would be - given the existing terms under which the regulator has to operate, that you could not discharge that duty in a light-handed manner? Is it something we need to change in the code or is it something in the various regulator acts that would need to be done in order to be able to get it towards a more lighter-handed one where the regulator could discharge his duty - in other words - appropriately? Somewhere there's a misconnect of our intention and the duties that a regulator must do, because we wanted to try and be lighter-handed. We hear your point as to concerns. Could you elaborate a little bit more behind that?

MR FARRANT: The point here is the price monitoring rule alternative.

DR FOLIE: That's exactly right. We're not going back to the other one, the other ones. We were just talking about - - -

MR FARRANT: Not price monitoring.

DR FOLIE: It's not price monitoring; it's behaviour monitoring. It's access plus also price plus a number of other indicators that might be agreed. They're out there in front. What appears to be your concern is, "Then we need to verify that information in great detail, et cetera, because we as regulators can't actually monitor something unless we actually know what we're monitoring and we're back to the paradox. We may as well stay with the other regime."

MR FARRANT: Perhaps I could start. The code actually provides an obligation on regulators to do certain things. The regulator's role is spelled out in the code, so if you want a price monitoring regime run with the regulator's involvement then it follows you're going to have to spell out what it is the regulator is supposed to do, because then he has authority to do it and he has powers to do it and he has a responsibility to deliver it. If he doesn't do it he can be criticised for that.

A specification of the task is what regulators actually need. If the task is to be done light-handed then a specification should say so and, in particular, I draw attention to an objects clause which says promotion of economic efficiency - in shorthand - and if you just give a regulator that objects clause and then tell him to go run a price monitoring scheme, you can bet he's going to do it with a determined approach to make sure that that's the outcome. To get that outcome he needs to be determined about it and intrusive and all sorts of things and the regulator will simply do it, because that's his legal obligation. To cut this short, you need to tell him what it is and how it is and say, "This is to be done only in this way." That will give not only the regulator clarification as to what legally it's required to do, but it will give great confidence to the people to whom the code applies.

MR HINTON: An element of certainty, yes.

MR FARRANT: That is a significant element in what comes through in your review.

MR HINTON: It's an important distinction between the Gas Access Regime having an overarching objective clause and that being seen as the objective of the regulator, because there are components of the regime that have an objective. Where the regulator fits into that is not the pursuit of that objective as an overarching objective, so that it would be an intrusive monitoring role seeking efficiency - because it's the regime with the objective; the role of the regulator for monitoring would be a subset of that. I hope that was clear in our draft report.

MR FARRANT: And as people who live with the code, and their legal obligations under the code - regulators, that is - their interpretation of that is, "If that's what you want, say so and put it in the code."

MR HINTON: Yes, I understand that point. Thank you. If that's what we mean, we'd better be precise.

MR FARRANT: Yes.

MR HINTON: Another area of broad thematic approach that you bring a particular expertise to is this question of timeliness. Les made a number of very focused comments on a number of draft recommendations and draft findings in the draft report, that touch on possibilities of improving and refining administrative arrangements and procedures that we're seeking to try and improve timeliness. The prior question here for us that I put to you is: are you endorsing this objective as needing to be addressed - that is, do you feel that timeliness has been less than satisfactory with regard to outcomes from the regime? That's not necessarily pointing the bone at you guys. Maybe the system itself is deficient and that leads to delays. My question then is: with your coalface experience, do you think that that is an area that has some potential fruit to be picked with regard to refinements to the Gas Code?

MR KOLF: I wouldn't mind commenting to begin with on that. Clearly we've had some considerable concern about the timeliness of dealing with the access arrangements that we've dealt with. I've made the point that timeliness has, in many cases, been guided by the parties and the complexities of the issues. In the case of Epic Energy, as an example, there were in fact 10 months accumulated - 10 months of public consultation. That 10 months of public consultation was at the request of other parties and it was provided on the grounds that it was reasonable to do that.

You do find yourself in a situation where you need to weigh up whether providing additional time for consultation and the time that you take in assessing a particular situation - you need to weigh up whether that time is well spent considering what are the possible consequences of not taking the time. To that extent, it's a decision for the regulator and to that extent, as I say, it is a matter that really is quite specific to the circumstances and what have you. Therefore, while we have a concern with the timeliness of these things, there are in our view certainly very good reasons why it has taken the time in each of the situations that we've gone through and we've maintained very careful records of how all regulators have dealt with these things. Indeed, there are only a couple that have really taken a really long time - or a small handful. The bulk of the access arrangements on the first round have all been done fairly well in the same sort of time frame. So I guess that does say something about the nature of the regime.

Reflecting that back on to the types of recommendations that have come in your draft report, I would say that my feeling there is that the approach adopted, or appears to have been adopted by the Commission, is one that would see an improvement in timeliness. Many of the very difficult decisions would appear to be decisions at the coverage stage and there is much greater focus, both in the case of monitoring and in the case of the more stringent form of regulation envisaged. There is more focus there on quite a narrow set of objectives, principally the economic efficiency objective. I could see that all of those types of changes to the regime would in fact simplify and reduce the scope for argument in the regime and produce a more expedient outcome.

It would need to be fairly clear that if a pipeline were to be covered under the more stringent form of regulation envisaged then the issue there is that economic efficiency would be a fairly significant outcome of that and that is a much more clearly understood circumstance than having to weigh up a whole wide range of factors which are currently specified under 2.24. So I can see that there are opportunities there for speeding up the process. That's really all that I'd like to comment on.

MR FARRANT: Considering what is at stake for property rights and for the economy in general out of this, then the investment of that time could seem justified in the first round at least. As the regime continues to operate, and you're not recommending that the regime change substantially for those pipelines that need price caps, then you would expect it becomes a more deliverable method, but nevertheless the opportunity is still for people to defend their natural rights, and natural justice to be exercised and public consultations are still going to take a certain amount of time.

This reflects, for example, in the lead time for submissions that are revisions to

access arrangements prior to the revision date. To leave only six months for such lead time is likely to make that process almost inoperative in terms of effective public consultation, whereas nine months is probably just enough and 12 months is probably too much. So in thinking forward as to how time frames will be in the future, there's going to be a sort of practical minimum when we're dealing with the sorts of issues that we're dealing with here in a public process.

MR HINTON: Thanks for those comments. I'd like to pick up a reference on page 9 to the regulator's forum that you're active participants in, and this is in regard to information requirements. In your draft submission you refer to your support:

> The ERA supports initiatives under way through the regulator's forum to settle on suitable standardised information requirements.

Is that a substantive statement? Are we really getting initiatives under way to standardise information requirements, or has this been running now for several years and nothing has happened?

MR KOLF: No, I think that to be fair the situation was that this was a matter before the National Gas Pipelines Advisory Committee which gave consideration to information requirements. There were a number of regulators, particularly in New South Wales, ourselves, to some extent Victoria and South Australia - all quite of the view that there were certain deficiencies in the current code in regard to information requirements. Several proposals were put to NGPAC to seek to remedy that. NGPAC had the view that if there were to be any such amendments then they should, at the very least, be consistently agreed and indeed that regulators should themselves put forward and agree on a set of common information requirements and to do that in conjunction and in consultation with industry. The outcome of that was that regulators substantially supported that and were happy to proceed along those lines.

We were also very clearly aware that the regulators forum and in particular, driven by South Australia - Lew Owens having put together a set of common information requirements for electricity. It was therefore felt that a similar sort of process should be adopted and that was certainly taken to NGPAC. Subsequent to that, however, NGPAC becoming aware that all of these matters were now to be under review, considered that it would be more appropriate to step back for the time being and that these matters to be dealt with at a higher level and therefore no further progress has been made to this date, but I would suggest that there is this underlying agreement or willingness on the part of the various regulators to deal with information requirements in that way.

MR HINTON: Thanks, Peter. A related point, an expression much loved by many

in the economic policy area - information asymmetry. You imply in your submission that this is sort of one of the prime sources of regulatory error that the regulator therefore has this asymmetrically access knowledge base regarding what is happening relative to the industry participants. My concern with this - which is why I'm asking the question or raising the issue with you - is that that takes you down a track of therefore a very powerful incentive for the regulator to seek more information, to address the problem by addressing asymmetry.

I raise this as a concern in that that is a never-ending spiralling upwards of costs of regulation. At the end of the day there always will be information asymmetry to some extent and, in any case, precision is always subject to uncertainty concerning market shifts, market developments, parameters being estimated, not concrete statistics. There is a nature of a regulator's inherent difficulties in pursuing his regulatory responsibilities. I really raise it with some sort of concern to say, "Are you concerned about that tendency as well; this pursuit of addressing information asymmetry?"

MR KOLF: Yes, I think I'd have to comment there that the information issue is very much to do with the timeliness of the process and I guess the best way and the simplest way that I can try and convey the regulator's dilemma in this area is that when you have before you a set of information and you're in the process of evaluating that and seeking to come to some sort of conclusion on that information, and you find that there are inherent in that information that you have certain inconsistencies, certain questions that you would ask if you were able to do that in order to be able to feel comfortable about moving forward on any decision - and bearing in mind that I think for a regulator to be able to confidently make a decision he needs to be comfortable with what he has in front of him - but if you're not in that situation and the only way in which you are able to achieve that comfort is to seek further information, then really that is the primary way in which the regulator can move forward.

The other alternative is simply to adopt some sort of more conservative and perhaps less desirable approach and that is to say, "Well, you know, I can't make any sense out of this, therefore I would have to conclude that a case has not been demonstrated to me and for those reasons I simply can't approve the situation."

MR HINTON: The onus of proof being back on - yes.

MR KOLF: These are the problems that I think you need to face up to in understanding the problems of the regulator in coming to a sensible decision on matters.

MR PULLELLA: If I might add that the process isn't one as described by you,

Tony, in the sense that we don't go to the infinite length of detail in establishing - it's only to establish a level of reasonableness, as is the obligation of the regulator within the code, and it's only to the extent that that is required that we would seek information. Now, that is something which one can say is objectively discerned by all parties to this process, or could reasonably be objectively determined. It's a case of providing that information. If the regulator's role is to be less certain as to the reasonableness, then that needs to be reflected in what the code says.

MR HINTON: I was trying to illustrate in clear terms the sort of tensions or pressures upon the regulator because of the information asymmetry that some read differently and that is - would put is occurring significantly; others would say it's pursuit of reasonableness, the comfort for the regulator. Then, of course, there is different perceptions on that.

MR FARRANT: I might just add that the asymmetry exists not just between the service provider and the regulator, but the service provider and a range of other stakeholders and their - what is it? - satisfaction with the operation of the code also depends upon at least some party in the system being diligent about the facts and the reasonableness of assumptions and so forth. So what the regulator is doing is on behalf of a lot of other people in that particular pursuit, not just simply between the regulator and the service provider.

MR PULLELLA: In other words, we're responding to submissions seeking that assurance as part of the process.

MR HINTON: A point of clarification for me, please. This underutilised capacity issue, your page 18 notes that underutilised capacity may be sold daily by a service provider - on a spot interruptible basis - with all proceeds being retained by the service provider. Is this occurring? There are strong pushes around from some in the sector that having some sort of spot market for available surplus - however you define it or describe it - gas, and that the system just doesn't seem to lend itself to be able to deliver that sort of product being put on and marketed because of absence of information. Can you give me a better feel for what is actually occurring here?

MR KOLF: Yes, I can. The situation in respect of the DBNGP, particularly under the previous access arrangement that existed - that is, the access regime I should say, gas transmission and regulations - it was open and it is open to the service provider to sell on a spot basis any capacity that is not actually used on the day. Now, that doesn't actually require necessarily a spot market or a day-to-day type of spot market; it can be in the form of almost in the nature of an interruptible contract that says, "Well, look, if no-one else is using the capacity on a particular day, consider me to be the number 1 person that would take that capacity off your hands." Right?

It's then just a matter of that party keeping in touch with the operator on that basis; that the pipeline isn't being utilised fully on this day, the nominations aren't in and therefore the capacity is there available for use on that basis. That doesn't, of course, preclude or take away the opportunity of a party that has contracted capacity that might, on that day, decide that they want to make use of that capacity. If indeed they do and they have the contract in place, then what it means is the party who might have thought they had come capacity but had an interruptible contract would then of course not have the opportunity of that capacity.

MR HINTON: But you particularly refer to the service provider having scope to put it into the market.

MR KOLF: That's correct, yes.

MR HINTON: Is there scope for a contracted customer deciding they don't really need all that; that's just contracted for them to put it on the market?

MR KOLF: It certainly is. If, indeed, before the final day they're able to enter into a spot contract or some sort of transfer contract - bare transfer contract or whatever - then they are able to do that and again, the capacity would not be available to the service provider at the end of the day to on-sell that on an interruptible basis. I guess the purpose or the underlying thinking there is that really it would be a waste of good capacity not to have an arrangement where you have in fact a default utilisation of the pipeline. In order to provide an adequate incentive for that to happen. it leaves it in the hands of the service provider to do that and to have the benefit of any such sales.

MR HINTON: The proceeds.

MR KOLF: Yes.

MR HINTON: Are there mechanisms around that might facilitate the expansion of this activity, like bulletin boards or postings or - - -

MR KOLF: In the case of the DBNGP there are, or at least there have been bulletin boards. I don't really know what the status of that is in this day and age. I haven't been directly involved in that for a little while now, but was involved in these matters earlier. Les may wish to comment: he was very closely involved in that also.

MR FARRANT: I think the mechanism for making spot - that is, day capacity - available is very much within the hands of the service provider. Revenue goes to the service provider and he'll therefore construct whatever mechanism he needs to find the buyers for that capacity - whether that's a bulletin board or some other ring

around, or whatever it happens to be. I think you can probably leave the service providers to worry about how they do that. The question becomes much more fundamental when you say there is a large chunk of capacity which somebody has got contracted in which the service provider doesn't believe it can run the commercial risk of selling, because it may be demanded by the current contract. That's the basis of the idea of use-it or lose-it concepts which, of course, you've included in your draft report.

MR HINTON: Raised, yes.

MR FARRANT: Raised, sorry. It's an item which is included. The response certainly from the secretariat is that if somebody has got a contract for that capacity they have every right under that contract to exercise it and they shouldn't be deprived of that contract right. We think there are other mechanisms which the code can foster and which - what is it? - natural business instincts of the service providers will follow to meet the market demand if there are still users who want to use their pipeline, for which they don't currently have capacity to contract.

DR FOLIE: Can I just clarify that the revenue earnt from the day trading - shall we say - is that then factored into the revenue cap and then goes back to what their return is - - -

MR PULLELLA: There's no revenue cap.

DR FOLIE: Or however it's determined; basically that's a bonus outside the regulatory - - -

MR PULLELLA: That's a bonus to the service provider that provided a secondary market mechanism in their proposed access arrangement and that was something outside of the regulatory regime.

MR KOLF: Indeed, under the access regime now approved for the DBNGP any such revenue is entirely available to the service provider and is not included in the reference tariff.

MR PULLELLA: And is intended as an incentive.

MR FARRANT: Given the incentive mechanism addresses market growth in the current format of the code, it's highly appropriate that revenue of that sort goes direct to the service provider, because there is an incentive to grow the market by the utilisation of the asset.

MR HINTON: Michael, how are we doing?

DR FOLIE: No, I'm right, thank you.

MR HINTON: I'm very conscious of the time. You've been very generous with your time this afternoon. Is there anything we haven't touched on we should have been touching on?

MR KOLF: I can't immediately suggest any issues, but I would like to say thank you for having been given the opportunity again to present to you.

MR HINTON: Thank you. Your participation and input is not only welcome, it's much appreciated. Thank you for your time today again. Thank you for your submission which we look forward to be able to put on our web site down the track. Thanks again.

MR KOLF: Thank you.

MR HINTON: That concludes today's scheduled proceedings but, as foreshadowed and in accordance with the Commission's established procedures, I now offer an opportunity for anyone else present to make a statement, if they so wish, with the usual requirement that they come to a microphone for the purpose of the transcript and identify themselves, and it's a serious invitation if anyone would so wish. In fact, in Adelaide, someone took it up. No-one is standing. So thank you very much for everyone's attendance today and their participation. It's been a very useful day here in the west. I therefore now adjourn these proceedings, thank you.

AT 4.22 PM THE INQUIRY WAS ADJOURNED ACCORDINGLY