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TRANSCRIPT OF PROCEEDINGS

PRODUCTIVITY COMMISSION

INQUIRY INTO THE GAS ACCESS REGIME

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

TRANSCRIPT OF PROCEEDINGS

AT SYDNEY ON FRIDAY, 26 MARCH 2004, AT 8.13 AM

Continued from 25/3/04

Continued in Public Hearing

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INQUIRY INTO THE GAS ACCESS REGIME

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

TRANSCRIPT OF PROCEEDINGS

AT SYDNEY ON FRIDAY, 26 MARCH 2004, AT 9.06 AM

Continued from 25/3/04

Continued from Transcript-in-Confidence

MR HINTON: Good morning, everybody. Welcome to this second day's hearings here in Sydney of the Productivity Commission's review of the Gas Access Regime. For the record, my name is Tony Hinton and I'm the Presiding Commissioner for this inquiry. My fellow Associate Commissioner, on my right, is Michael Folie. The inquiry terms of reference were received from the Treasurer in June 2003 and covers in brief terms the following six matters: first, the 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 and decision-making arrangements under the regime; and sixthly, the appropriateness of including in the regime minimum requirements for access to users, such as price and non-price factors.

The Commission is grateful to the various organisations and individuals who have participated already in the initial round of hearings last September and through earlier submissions. This round of hearings follows the release of the Commission's draft report in December last year, and the purpose of these hearings is to provide an opportunity for interested parties to discuss their submissions on that draft report. Participants are welcome to also comment on views expressed in other submissions. Hearings have already been held in Melbourne and Brisbane, and further hearings will be held next week in Adelaide and Perth. The Commission is on track to produce their final report in time for submission to government as scheduled in mid-June this year.

As I'm sure most of you know, we like to conduct all hearings in a reasonably informal manner but I remind participants that a full transcript is being taken and, for this reason, comments from the floor cannot be taken but, at the end of the day's proceedings, 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. I also note, as you probably know, that submissions to this inquiry are also available on the Commission's web site. To comply with requirements in the Australian

government's occupational health and safety legislation, I draw attendees' attention to the fire exits for this room, which are through the door at the rear of this room, and to your right. I understand this building operates a standard evacuation alert system.

I would now like to welcome our first presenters this morning in this public hearing, and to the microphones I welcome Mr Bob Lim and Mr Terry Dwyer, representing Energy Markets Reform Forum. Over to you. To set proceedings under way I welcome an introductory statement from you and then we can move to discussion session.

MR LIM: Thank you very much to the Commissioners, and in particular to the Commission for the opportunity to present our views. We would like to make an opening statement of about 10 minutes or so and we'll leave copies of our presentation behind after we finish, and then we will be happy obviously to take questions or elaborate or clarify any of the points that we've made. If we are unable to do so we will clearly follow up with written comments. The Energy Markets Reform Forum is basically a major energy and energy infrastructure users group and comprises a number of companies, including BHP Billiton, BlueScope Steel, a number of aluminium companies, a number of paper companies and a chemical producing company.

The overall view that we have of the draft report is that the draft report is disappointing. It contains contentious and inappropriate recommendations that we believe will whittle away the benefits gained from the operation of the Gas Access Regime in recent years, and will substantially disadvantage upstream and downstream investments as we move forward.

We also believe that it is intellectually flawed. It fails to provide an economy-wide assessment of the (indistinct) losses caused by monopoly pricing of strategic infrastructure and seems to assume monopoly away. We don't believe that it has met the terms of reference of the review. There are many places where we believe the evidence from the consumers and non-pipeline industry stakeholders have simply been ignored. We believe there have been inadequate investigations. We believe also that there have been many assertions in many areas with no evidence provided. Finally, we believe that certain draft recommendations are so dangerously flawed that they are major risks in distorting the operation of the Gas Access Regime and we find that very disturbing.

Before I go into further elaboration of those overview points, let me pass across to Dr Terry Dwyer, who will make the critique of the implicit model that the Productivity Commission's draft reports seems to be based upon. Could I hand over to Terry Dwyer.

DR DWYER: Yes, as you'll be aware, as an economist, the first thing you do is ask yourself: what is the model? What are the implicit assumptions underlying the reasoning? I found it very difficult, reading this report, to understand that until I started putting things in place. It seems to me that essentially being economists we like to economise and sometimes we economise too much by assuming the problem away. In our submission you'll see we have a little joke there, a well-known one about economists saying, "Let us assume there is a tin opener when stuck on a desert island with a tin." It struck me the report fell a bit into that trap, which we are all prone to. I can have some sympathy with what the report is trying to do. Obviously monopoly is a fact of life and the trouble is most economists don't define their terms properly. It's a very lazy intellectual habit.

Some people say, "Monopoly doesn't really exist. Can you say a brain surgeon is a monopolist because he's got a unique talent? Anyone else can enter." I think the trouble is that the report hasn't thought enough about what monopoly is, and it's tried implicitly to assume that there is no monopoly because anyone can invest in a pipeline, and we would argue that that is not factually correct; that what it has failed to do is disaggregate the factors of production into land, labour and capital. True, there may be no monopoly in capital or labour, but easements, the right to build a pipeline, is a privilege granted by the state to override a normal private property rights. It is registered on land titles; land-holders have no choice but to lump it, and that is a coercive power of the state being used in favour of a particular enterprise. That is where the source of monopoly lies. You can't seriously expect that there could be 23 pipelines from Moomba to Sydney, and anyone who bowls up to the minister for mines and energy in New South Wales is going to get a licence to run through public and private lands for several hundred miles.

In a sense, when we dug into it, what we realised was that essentially this is like a lot of very common, I'd say - I don't want to be rude, but I'd say bastardised neo-classical thinking in the sense that you've got a spaceless, timeless economy where the only factors of production are labour and capital and the only one that really matters is capital. Space is assumed away, spatial rents are assumed away, time is assumed away, the first-mover advantage or the first come first served advantage is assumed away, and the interests of succeeding generations of consumers and users are just assumed away.

The other thing, too, is that it's a closed economy. The point is, 1 or 2 per cent may not be much in a price, but 1 or 2 per cent in international business can mean that you lose an industry and 50,000 employees. Basically there is no analysis here of what rising infrastructure costs may do - whether above marginal costs - to the export competitiveness of Australian industry and driving jobs offshore. This is not an academic issue. At the moment there is a big debate going on in the United States in the presidential election about US jobs going to China, because of the artificial

subsidisation of the exchange rate allegedly. All I'm saying is that in the real world any form of cost disadvantage to multinational enterprises will see jobs leave a country.

In fact, a couple of years ago there was an article, I think in the American Economic Review, talking about the car industry and how it strategically invests in redundant capacity to play countries off against each other; the idea that industries don't move from an economy is just wrong. I noticed in a couple of places in the report it talked about, "Well, this is not a big cost; it's only a small part of the cost of the overall product," but even small amounts in the total cost of production can be significant enough for profits to cause a footloose industry to leave. All industries are footloose in the long run, if we're going to talk about the long run. Car manufacturers can close down; we've seen new economies emerge in the last 30 years; Asia has industrialised.

I think, to sum it up, there has to be a more careful going over the report to define terms and to define models and say, "What are the economy-wide, excess burdens or deadweight losses inflicted on society and the economy by the capture of monopoly rents in excess of cost?" The other thing, too, is I do think the report fails to distinguish between capital, in the sense of reduced means of production, and the construction of physical infrastructure and capital vale in the sense of capitalised monopoly rent.

For example, take the Moomba-Sydney pipeline. It was built by taxpayers in the 1970s, if I recall correctly, and later sold - - -

DR FOLIE: Built by AGL.

DR DWYER: Then it was taken over by - that's right, Rex Connor.

DR FOLIE: Bought by compulsory acquisition by the - - -

DR DWYER: That's right, and then it's been sold back subject to a regulatory regime. The value of an asset is its ability to bring in an income stream. That value may differ completely from its cost of reproduction. Normally the cost of reproduction will constrain in a competitive market the value that is put on an asset, but where there are unique aspects to an asset, such that it's not readily reproducible, then the capitalised value will really reflect its ability to extract monopoly rents. The point therefore is you don't have free entry.

In the paper I think we've referred to a very good book, actually, by Israel Kirzner, who is a neo-Austrian economist who did a critique on monopoly theory and I think a lot of his criticisms were quite right; that standard neo-classical

economics was naive in thinking that competition meant that you had supply and demand curves of particular shapes. He was right in focusing on barriers to entry, so that's why we've drafted our analysis in terms of saying, "What are the barriers to entry?" I think we can successfully identify them as the fact that nobody can bowl along and get an easement at will. There is just no possibility of 23 pipelines from Moomba to Sydney or anywhere else. This is necessarily a highly regulated industry in the sense that the key thing you need to enter it is in the gift of government.

I'll just stop there for a moment and then we can go on but, to sum up, the model is a spaceless, timeless economy where there's no spatial economy, there is no land rents and there is instantaneous access for all participants in the economy for all future generations. That's the way it seems to me anyway.

MR LIM: If I can continue, Mr Chairman.

MR HINTON: Sure.

MR LIM: I would now just bring to attention a number of key points from the draft report in particular, some of the draft findings and in particular some of the draft recommendations, and make our responses to those items. Firstly, the draft report states that market power is constrained by a number of factors; for example, the availability of substitutes, the size and concentration of users, the elasticity of demand for the final products and so on. Our response to that particular draft finding is that it has basically failed to recognise the evidence provided by end users that the ability to substitute energy sources for gas is limited and I believe, Mr Commissioner, in discussions with you and in submissions, that a number of end users have pointed to the fact that for technical and contractual reasons it is just simply impossible to substitute that easily. For example, I believe that Orica had a company that had mentioned they use gas as a feed stock and there certainly is no opportunity for substitution there. The industry also operates on long-term contracts and so therefore the ability to substitute in the short term might be difficult. There are also technical considerations as well as cost considerations in switching.

We also point to the fact that, for example, the structure of the New South Wales gas market is characterised by a vertically-integrated dominant gas retailer, which has distribution networks and is also a significant owner of a major gas transmission business, so the ability to exercise market power might be there. We also believe that even if there are two pipelines, as in the New South Wales case, there is no necessary evidence that there is no market power being exercised. For example, we make the point that for the Eastern Gas Pipeline to increase its market share it will be dependent on the ability and the willingness of the Gippsland Basin producers to make available that increased production and supply.

In our submission, chairman, we pointed out to the NCC's final recommendations on the coverage issue concerning the Moomba-Sydney pipeline, where there were some discussions on the fact that demand elasticity for gas as an input is much higher than some of the proponents of the supply site might suggest. We pointed to a number of examples where, in the case of the price difference between the ACCC's final recommendation on the Moomba-Sydney pipeline access review application and the original application, that the difference there between those prices is quite significant for a new gas power generator as well as quite significant also for a producer of fertilisers. I won't go into the examples, but in the notes that I'll hand over I'll point to where we contain those examples.

The second point about market power which the draft report makes is that effective competition is evolving. Our response is - and excuse me for repeating it again - that two pipelines do not necessarily mean competition and we would like to bring the Commissioner's attention to the original two airlines policy where there was really limited competition and services - in fact, there was parallel scheduling as well as parallel pricing. So we are not so convinced that effective competition is evolving.

We think also that the draft report's finding that effective competition is evolving is also somewhat premature because there are really no real alternatives in gas transportation; say, for example, from the Moomba fields to the Sydney region. There are simply no two pipelines from Moomba to Sydney. We believe, too, that the Commission has been somewhat curious, I suppose, in a sense, that no assessments of overseas experiences have been made in the draft report. For example, we point to the fact that in the US gas market, which is supposed to be a mature market with about 300 pipelines, there is a very strong regulatory regime.

In fact, the general understanding is that most people have been critical of that particular regime. It does beg the question as to why, with so many pipelines in the United States and a reasonably mature gas market, there is still that regulatory regime. Perhaps the United States might have a better understanding about the issues of monopolies driven by the possession of easements. They are the very points that Terry Dwyer was alluding to earlier. The draft report states very strongly that, "The regime deters and distorts investments, possibly altering the nature and timing of pipeline projects and delays to pipeline construction or pipelines built fit for purpose." The draft report also uses words like, "Strong likelihood of investments in pipelines being affected by the Gas Access Regime."

Well, the EMRF's response is as follows: the draft report framework, we believe, ignores the wider issues and we've pointed out the fact that it has ignored the deadweight losses from monopoly rents. We also should point out that in earlier EMRF submissions we had pointed to the experience in the UK of lighter-handed

regulation and the report does not seek to discuss nor indicate that it has looked at the UK experience to learn from some of the UK experience. The draft report also focuses on investment in pipelines. As we mentioned earlier, there is a suggestion that it appears to be operating in a closed economy. We don't think that there has been evidence provided or even investigations undertaken of the assertions of deterrents and distortion.

We don't believe also that there has been any cost-benefit analysis provided of access regulation. For example, we don't believe that the draft report has looked at any of the ACCC's decisions on its access reviews or even looked at any of the state regulators' final decisions on access reviews. Nor, we believe, has the draft report looked at the NCC's coverage decisions on some of the major pipelines. We don't believe the draft report has also looked at some of the rates of returns provided by regulators to assess or analyse whether investments have been deterred or are likely to be deterred as a result of those regulatory decisions. We also note finally that the NCC's coverage criterion, criterion D, the public benefit test, at least undertakes some cost-benefit analysis and we ask where was the draft report's analysis of the cost benefit of the operation of the Gas Access Regime.

I move on to the next point. The draft report states that, "There are significant compliance and administrative costs. Delays have added to costs." Again, the EMRF response is as follows: there does not appear to be any evidence or data provided to allow the draft report to make such a strong statement that there are significant compliance and administrative costs. There is no analysis to show that marginal costs have exceed marginal benefits. It also ignores that pipeline costs have fallen, despite the significant costs attributed to regulation. We note finally that there is no incentive in reality for pipelines to reduce regulatory compliance costs simply because they are permitted to recover those costs, so there is no incentive for them to minimise compliance costs.

I move very briefly to draft recommendation 5.2. The draft report recommends the deletion of the objectives in the preamble in the current Gas Code. Our response would be that we are very concerned with removing B, which is the prevention of the abuse of market power, and D, the fair and reasonable right of access. We are happy to have a discussion on that. We don't believe that you can assume monopoly away and therefore take away those two clauses which provide a lot of comfort to end users. We believe for that reason the PC has not established that there is no market power currently operating.

On draft recommendation 5.3, the draft report recommends the deletion of elements of section 2.24. Our response is that we are opposed to the deletion of (f), the interests of users and prospective users, for a number of reasons. We also believe that if economically efficient use of an investment in pipelines is not equated with

prices to a short-run marginal cost, then the elements relating to the interests of users, preventing abuse of market power and access on fair and reasonable terms must be retained in section 2.24 of the code as well as in the preamble, if only to provide some comfort to users and potential users that their interests will not be compromised.

On draft recommendation 6.6 - the substantial and material competition coverage test - our response is that it is a major dilution of the code based on what we believe to be little analysis or evidence. We also believe that it's a legal nightmare and that will emerge in a legal gridlock which would emerge from those suggestions. I think lawyers have already started looking at a few pots of gold that might emerge in the future, should such draft recommendations be taken on board. We believe that it will simply tie up the NCC and the major gas pipelines in the courts. We believe that this is a very dangerous recommendation.

On draft recommendation 6.7 - the monitoring option to apply for five years - our response is that it prevents major risk for gas users because by actually proposing that, the draft report is admitting that monopoly rents do exist. Secondly, we would like to ask what sort of mechanism is being provided to extinguish monopoly rents immediately if monopoly rents were found to have existed within the five-year period or shortly after the five-year period. We also point to the fact that the airports' monitoring example does create some fear in the minds of gas users. Finally, we believe that you will fritter away the benefits that have been obtained from the operations of the Gas Access Regime.

Finally, chairman, just some concluding remarks. Overall, major gas users strongly consider the draft report to be fundamentally flawed and that its major recommendations are likely to reverse the benefits upstream and downstream industries, as well as the pipeline industry, have gained from the current Gas Access Regime. They have, we consider, chilling effects on investments both in upstream and downstream sectors. The Gas Access Regime, we believe, is working, contrary to the assertions of the draft report which incidentally does not provide any evidence to support its claims. The market power of the natural monopoly pipeline industry is strongly evident. Competition is still in its infancy. The gas market is not mature and monopoly power cannot be simply assumed away.

Regulation has not deterred or distorted investment in pipelines. To the contrary, we argue that investments in upstream, midstream and downstream industries have been encouraged by the operation of the regime. We also believe there has been no rigorous analysis of the key issues asserted by the draft report and that is pretty apparent. It has been uncritically accepting of the views put by the pipeline industry. There has not been any apparent cost-benefit analysis undertaken. We pointed to a number of examples in my earlier remarks - for example, has the

draft report looked at any of the regulatory decisions made by the ACCC? There has been no economy-wide analysis presented. It appears to be operating on a closed economy assumption. I think, because of that, we believe that there is only a partial analytical framework presented.

We finally believe that some recommendations are dangerously skewed against consumer interests, whereas others also present risks of tying up the courts and the NCC over legal issues. Whilst we have been critical, we also say that there have been some positives in the draft report, but we believe that the negatives of the draft report are pretty overwhelming. Thanks, chairman, we are happy to discuss, defend and explain any of our points. As I said before, if we are unable to do so, we would like to take them on notice and follow up with written responses.

MR HINTON: Thank you very much, Bob and Terry, for those comments and for your substantive submission. The participation of the EMRF in the inquiry is appreciated. I have a number of questions, partly in response to your submission but also in reaction to your comments this morning, though I don't think it's going to be fruitful to go into every detail of every one of them because there is the debate that's going on within the documentation, so the purpose of this morning I think is to use the time available to sort of explore some of the nuances of areas of some interest that intersect, where our views intersect - perhaps not in agreement.

MR LIM: Okay.

MR HINTON: One that didn't emerge from your submission, or certainly not from your presentation this morning that comes to mind, is this issue of transmission versus distribution. Under our terms of reference, it's pointed to the fact that there are differences between transmission and distribution, but there is a single Gas Access Regime. Is it appropriate to continue with a single regime and have flexibility to handle the differences between transmission and distribution? What's the perspective of the EMRF on that issue?

MR LIM: I guess the response to that is that we recognise that there are differences between transmission and distribution pipelines, but we also think that we should only stay with one single access regime if only for consistency's sake. Once you have two separate regimes or have different treatments, if you like, or different provisions for different pipelines, you run into problems of uniformity, interpretation and you run into problems of consistency.

You also run into problems where there might be cost-shifting opportunities available in cases where the owner is also owning transmission as well as distribution pipelines assets, so there is the potential to shift cost from one area to another - you know, reflecting any number of reasons. If a particular regime is less strong, if you

like, or less investigative than another regime, then obviously there will be some shifting of the cost. The simple answer is we believe there should be a single regime operating for both transmission and distribution pipelines. In closing, I should also say that I suspect the regulators also do make allowances to recognise that there are difference between the two pipelines.

MR HINTON: Thanks for that. I now wanted to take up some points you made about market power and it's not surprising, in the process of an inquiry of this kind, that we have presented to us extremes from both ends and views in between. There are those that say that national monopoly characteristics - ipso facto monopoly power; those that say there are a whole range of forces out there that can constrain the deliverance of or capacity to apply natural monopoly characteristics, and in particular we note that in our draft finding 2.1, that you partially quoted, you left out the important last sentence, which was the extent to which these factors constrain market power differs across pipelines.

That's trying to illustrate the point that there is a raison d'etre for intervention, natural monopoly characteristics, but it is not black and white circumstances; there need to be judgments about when these natural monopoly characteristics come to bear to apply capacity for market power. That leads to all sorts of judgments. That construct is very important for how you read the report.

MR LIM: Yes, and chairman, I had anticipated that you would point that out to me and, as a result, I have a response in anticipation of that comment. Our biggest concern really, chairman, is that the whole thematic aspects of the draft report - it takes a very strong pipeline interest approach so, for example, even in the discussion and the draft finding on market power, the casting of the words is in a sense that there are constraints on market power, but it then concludes, "But it applies differently in different pipelines." I could easily have said, "You could have cast the words around and said that market power applies in a number of places in a number of sectors and here are a number of reasons, but market power may not apply, or it may apply in different circumstances and different pipelines."

If you take the helicopter shot and look into the draft report itself, it takes a very strong pipeline interest approach; hence our criticism that (a) the report has not looked at the economy-wide impacts. Its analytical framework is partial; it has not looked beyond closed economy and it really has not looked at the impacts on upstream and downstream industries, and therefore, chairman, hence our criticism of that draft finding, that its wording is constructed in a way as to basically follow through the whole theme of the report which is basically, we consider, to be a draft report that takes very strong pipeline interest positions.

MR HINTON: We're very disappointed you have read it that way, because others

don't. But more importantly, the Commission tries to have an approach that looks at these issues from Australia as a whole, without any particular sector interest being prosecuted, protected or whatever. Importantly, the mind-set is to do with justification for regulation. If you look at our words and our constructs of recommendations and findings, I would hope you would see rather an approach that says the onus is on those who want regulation to show that regulation is justified and that the benefits will outweigh the costs; as opposed to an approach that goes, "Show that removing regulation will generate benefits". It's that difference of mind-set that I think can colour how people will read the findings and recommendations.

MR LIM: But, chairman, before I invite Terry to respond to your comments there, I should also add that in the draft report's discussion section on market power, if my memory serves me correctly, it avoids any mention which Orica and a number of users provided in submissions and in discussions with the Commission, that there is no opportunity for substitution because of the nature of the operations. There was no discussion in the draft report, from memory. There was no discussion in the draft report of the fact that many companies are on long-term contracts or the opportunities for substitution are not there. Again, I go back to my original point, and the flavour is one that tends to ignore what consumers have put forward in submissions and in discussions to the Commission. Perhaps Terry might want to speak.

MR HINTON: Terry, do you want to add?

DR DWYER: Yes.

MR HINTON: Sure, please.

DR DWYER: I'd like to take this point up because frankly, I'm lazy, too. I would like to assume monopoly away. I understand why somebody doesn't like regulation. Personally I hate regulation myself. But I think the point is this: so long as you can charge a monopoly rent, by definition you must have market power. The fact that your market power is not infinite doesn't mean that it can be ignored. Essentially, any ability to price above marginal cost in the long run must illustrate market power.

MR HINTON: In the long run, yes. In the long run, importantly.

DR DWYER: In the long run, but basically I'd like to say that you've made this point that the onus should be on those who support regulation to defend it, and I think the argument is simply this: a pipeline operator is given by the crown an extremely extraordinary right to override public and private land-holders' rights, run their damn pipeline through my backyard, or whatever it is, and I - as a property owner - can't dig it up, blow it up or get rid of it. So basically you go right back to

the property rights argument. You're being given a privilege by the power of the state to override other people's property rights; they have to let these pipelines go through, transmission pipelines, distribution pipelines or whatever.

So if you are asking that from the crown in the name of the people, then surely the people have the right to demand that if they have to give easements to you for nothing, no rent, then they in turn have a right to demand that you get no more than a normal commercial rate of return on your infrastructure. That's the bargain; it's a deal, and that is the way, when you think about it, public utilities have always been created - on that implicit understanding. That implicit understanding was not necessary when public utilities were publicly created.

These easements were originally given in most cases to public operators, in the case of gas it was the Australian Gaslight Co who got a royal charter from William IV to run their pipes down the streets of Sydney, and again, it was this implicit bargain. The crown doesn't give these rights to anyone, and that's why I made the point about freedom of entry being the key to this. I can't go along to the crown, to the governor of New South Wales, and say, "Please, can I set up a $20 million company and start running pipelines down the streets of Sydney" Of course, people would laugh at me, so the onus I think is discharged when you think of this observation. How many of us have this unique privilege to go over other people's land and use their land free of charge without paying rent.

That's the way it must be. It would be crazy to have a system of networks where every little land-holder could destroy the utility of a vast public system of provision of utilities by saying, "I want rent on my block of land," or if a land-holder in western New South Wales could say to AGL, "Look, I don't want your pipeline over my land now, go and take it away." It would be impossible to have the benefits of this sort of thing, but the quid pro quo has to be there.

MR LIM: Could I add a tail-end to that, because in a sense the chairman's question to us is very much akin to saying the onus of proof about anti-competitive practices in the community should be on consumers or on the part of users or consumers or taxpayers - - -

MR HINTON: Don't put words in my mouth, Bob.

MR LIM: But the analogy is there and that we shouldn't have the Trade Practices Act at all, unless the onus of proof has been taken up by consumers that they are anti-competitive trade practices in the economy. I think the analogy is the same - is similar to what you've just posed to me by way of regulation of pipelines.

DR FOLIE: I believe that easements are gettable. For instance, there is a second

pipelines that goes from Moomba into Sydney. It's a gas pipeline. The first one was built in 69; the second one was built somewhere around about the early 90s; the ethane line that goes to Botany. The point is that if you've got a proposition - in other words, a development proposition to do something - then you go through the normal development approvals and getting an easement is not easy, but nor is any development approval easy. But it's relatively achievable in a time frame. I can think of very few examples where a pipeline proposal has been stopped because of being unable to get any easements. They've built near the SEA Gas pipeline, got all of its easements.

That is a special - as you say, quite correctly - within the law to be able to do it. Consequently the easement is a form of advantage, but it's not necessarily the ultimate barrier to entry. I think that for distribution it raises an issue. It may be - and I'm (indistinct) impossible - to get one and this is not really relevant because in fact we have double telephone line systems and things in Australia, so it's difficult, and you are quite right - because the government is giving you a development right as it gives you a development right to build a 50-storey building where there are only residences. There are all these sorts of issues, but it is, I think, probably no more a significant source of monopoly rent than it would be any other sort of advantage.

DR DWYER: I don't agree with that.

DR FOLIE: I didn't think you would.

DR DWYER: No, I don't, and I am quite happy to debate it because it seems to me the reason you don't get multiple easements is that it is first come, first served. Remember I hit on the point that this is a timeless economy. The truth is, once somebody has got an easement and used it, they're in a position, having sunk the infrastructure and having eventually established themselves to be in a position to undercut any future competitor, so nobody will bother to get a second easement. If you're smart and you build enough capacity in, you can probably deter anyone entering. In other words, it's a unique historical opportunity and some things in history are irreversible. The other thing I would say is, in terms of easements, the point about an easement is that it does override normal property rights.

I, as a land-holder, cannot veto the minister's decision and the minister will be very careful about giving an easement if he realises there are going to be 2000 angry land-holders along the way saying, "We've already had one pipeline through. Why a second?" but I do think there is that basic point - that if the public is being asked to surrender their normal property rights in favour of somebody for no cost and have no right to charge rent, why isn't the public entitled to say, "Well, that person should be subject to a regulatory regime," which means that he doesn't profiteer? If I have to give my land to him for nothing to use, why should he be charging me more than it is

costing him?

DR FOLIE: I'm prepared to let it go because it's a wider issue.

MR HINTON: This discussion about market power is an important one and that's why we have been spending some time on it, appropriately, but we have had the same discussion the other way with some other interested parties who say. "There is no market power. Don't intervene," and its position-taking from extreme that causes us some puzzlement. In our draft report we're not saying that there is no market power operating in this sector; in fact we do think there are significant grounds in certain circumstances for intervention by regulatory form that actually impedes the misuse of market power that flows essentially from national monopoly characteristics.

What we also say, though, is that that is not sector-wide generic, full stop; therefore intervention should be total coverage, total intervention. We say that circumstances will vary across the sector. Intervention is not costless. It therefore is important that you do not intervene when you shouldn't be intervening because then, by definition, the costs will outweigh the benefits. It therefore follows you need a regulatory structure that allows you to make judgments that lead to conclusions as to the right time, right places to intervene whereby the benefits will be greater than the costs. We're not challenging your statement that market power exists. On the contrary we are agreeing with you, just as we are also agreeing with some others who say, "Yes, we agree market power doesn't exist. In those latter cases intervention shouldn't occur. In the former cases intervention should occur." The debate should be about the criteria that determines and underpins judgments about the intervention because regulatory intervention is not costless.

MR LIM: Yes, and I should say that regulatory intervention also brings benefits. I mean, the obverse of the coin is that there are benefits from regulatory intervention, but I might say, too, chairman, that we - - -

MR HINTON: But usually it's third, fourth-best.

MR LIM: Yes, but that's the nature of monopolies.

MR HINTON: I agree that there can be benefits in certain circumstances.

MR LIM: Yes.

DR DWYER: You know, we did point out in our submission there is a first-best and we used to have it in this country. Eminent economists like Hotelling and Vickrey have admired us for it. We used to have a system whereby for public

infrastructure we rated the lands benefited to amortise the fixed costs of the infrastructure and then operated it free. That's how highways are financed now in many cases: the land-holders are rated to pay for the roads and they're available to the community free.

You have said in this report and acknowledged that the optimum is price equals short-run marginal costs which, in many cases, is close to zero. Now, take the reasoning of this report and apply it to highways. Is there competition or no market power if you privatise the New England Highway and the Pacific Highway simply because there are two methods of getting from Sydney to Brisbane, or the Princes Highway and the Hume Highway - two methods of getting between Sydney and Melbourne.

MR HINTON: There is rail and air, as well.

DR DWYER: I mean, monopoly and market power does not equate with the ability to demand an infinite price. Even the most rapacious monopolist can't demand an infinite price - he can't kill the goose that lays the golden egg - and there will always be argey-bargey but, as Rupert Murdoch once said - and I think I have quoted it - "Monopoly is a terrible thing until you own it" and, as an investor, I like to invest in monopolies - I'll be honest - and, frankly, if you liberalise this regime, I'll certainly buy more shares in certain companies but, as an economist and in terms of the public interest - the public interest - as Hotelling pointed out in the 1930s, lies in making sure that infrastructure is available to the community at short-run marginal cost.

Infrastructure is not going to be serving the community efficiently if you are trying to recover some costs from 50 or 100 years ago. It will not be serving the economy efficiently if the infrastructure owners are trying to recover inflated costs they may have paid to acquire a valuable franchise from government - that's just tax farming - it's a licence to tax - and to the extent that you allow that sort of thing to go on, you are destroying the competitive advantage of Australian industry and telling companies they might as well take their jobs and their manufacturing plants offshore and, if that's what you want to do, fine, but don't delude yourself as to what the consequences of your actions are.

MR HINTON: I think you have set up a hypothesis that is not in the report, but let's move on to objectives.

DR DWYER: Well, as long as there are monopoly rents allowed, that is exactly what is in the report. I beg to differ.

MR HINTON: We differ. Let's go to the objects clause. Bob, I think you referred to draft recommendation 5.1, and then also talked about draft recommendations 5.3

and 5.2, from memory, about certain rejigging - proposals to rejig the documentation within the gas access regime, trying to bring greater clarity - this is our intent - and less conflict in the documentation as to what is the objective of the Gas Access Regime. We importantly felt that there was a need for an overarching objects clause. In your comments you sought to focus on the minutia as opposed to the big picture. I would welcome your reaction to the force of 5.1, and then we can look at 5.3.

MR LIM: I guess, chairman, if the economically efficient use of investments in pipelines is equated with, as I said, prices to a short-run marginal cost, there's absolutely no problem with the objects clause as presently suggested by the draft report, but where there is a huge range of possibilities - towards economically efficient costs or, in the interpretation of economically efficient use of an investment in pipelines, then from a user's point of view there is some request for some security that the objects clause is about also making sure that there is no abuse of monopoly power. We support incidentally the need for an objects clause. It is in the minutiae, as you put in the words and in the interpretation, which we believe are important. Getting rid of the abuse of monopoly power gives a lot of comfort to users.

MR HINTON: We also had yesterday objections from some about deleting the sort of reference to legitimate business interest. This is also in 2.24, where you object to deleting the reference to misuse of market power - no, you don't. The interest of users and prospective users, I think, in your submission, where there is this listing of various interested parties in effect. Perhaps we have got it right if we have upset some by deleting one and upset others by deleting the other. We cannot satisfy both unless we can get agreement hopefully down the track on the overarching objects clause, but we're not going to go into debate this morning at 10 o'clock on sort of arguments or literature associated with marginal cost pricing or whatever. That won't be helpful.

MR LIM: But, chairman, you must accept the point that there is a very large range in terms of the understanding of what economically efficient prices are and therefore that abuse of monopoly power item gives some comfort that it is not that far. It is perhaps that far, which is towards short-run marginal cost pricing. That's economic efficiency. I'm also not too comfortable, too, that the whole focus should be investment in pipelines. Where is the public interest in terms of the economy-wide benefits? That's the whole intent of the Hilmer reforms and the deregulation of natural monopolies - is the wider public interest; not investment in a - - -

MR HINTON: Yes, upstream, downstream.

MR LIM: And that focus is very much on just one sector of the economy.

MR HINTON: Thereby promoting competition in upstream and downstream

markets.

MR LIM: But investment in pipelines.

MR HINTON: Efficient investment in. It's not just investment - efficient investment.

MR LIM: Yes, efficient investment.

MR HINTON: Just as "use" has the words "economically efficient" in front of it, so does "investment".

MR LIM: Gentlemen, all we're asking is for some level of comfort which might ease the anxiety of end users.

DR DWYER: I wonder if I could make a comment. I do understand the Commission's predicament. We would love to assume monopoly away. I mean, I am deregulatory in my - - -

MR HINTON: You keep saying it, but we don't.

DR DWYER: We can't. This is the point, we can't.

MR HINTON: You can use your time this way if you like, but it's not productive.

DR DWYER: Exactly, but what I am driving at is that there is a suggestion in the report, for example, that there be access holidays or regulation-free periods, where an investor may take his chances on an entrepreneurial pipeline and be unregulated for 10, 15 or how many years, but surely the quid quo pro for that is that if you are going to give somebody a free rein at using a monopoly for 15 or 20 years, then at the end of that period it should be gone, just like a patent. You've had your chance to recoup your costs from a period of monopoly.

It should then be compulsory for that pipeline to be made available at marginal cost or vest in public ownership, just like with boot schemes. I mean, we give a monopoly on the eastern distributor for 25 or 30 years or whatever it is and then, at the end, it reverts to the crown to be available as a public asset, with all those sunk costs written off, but what will absolutely destroy this economy if time and again consumers and industrial users are made to pay again and again and again for the infrastructure costs of existing sunk assets which were amortised in previous books of previous companies or by the taxpayer and that is, I think, a disaster.

MR HINTON: Do you see that concept, the boot concept, applying with equal

force to both transmission and distribution - which is partly behind my very first question about 20 minutes ago.

DR DWYER: I can understand your argument about transmission and distribution.

MR HINTON: It wasn't an argument.

DR DWYER: No, no, your point. In other words, you were trying to say is there a difference like with telephones, where we used to have problems with long distance when we had to use cables between countries and now we have got satellites and suddenly long-distance phone calls are more competitive than the local loop. I must say I don't think that technical situation is arising and I do think that in fact there is still - as Bob said - an argument for keeping them all within the one regime. I don't think one has suddenly become more competitive. Let me put it this way. Gas has to go through physical pipelines. We can't beam it up to a satellite and bypass the stuff on land at this stage of the game. If somebody can invent a technical procedure for annihilating space and time, I'll be indebted to them, but we haven't got there yet.

DR FOLIE: The problem is that the gas field mightn't be there in 50 years' time.

DR DWYER: Exactly. Economists love this idea that technical progress will always eliminate monopoly. It often does but then it creates more monopoly rents, like access over broadband or spectrum rights.

DR FOLIE: Can I just ask a point of genuine clarification. This is not about the philosophy. Is there a structural difference between the way gas gets to large users in New South Wales compared to, let's say, Western Australia, where, in Western Australia, the large users can generally have - in certain cases you can actually deal with the gas supplier. In other words, you get genuine access and delivery, and you may have a spur line - in other words, you can bypass, whereas it seems in New South Wales that, in essence, very large users are actually going through a retailer - in other words, they don't have - is that a structural impediment in New South Wales or just the way people have chosen to do it commercially?

MR LIM: I'm not as familiar about the WA situation but so far as the New South Wales market structure is concerned, I think you're probably right. My understanding from my members is that it's something that has developed historically and it's just been impossible to try to get unbundled prices in the sense of being able to generally negotiate with the supplier rather than via the retailer. There are one or two instances where that has been possible but that is probably not the norm.

DR FOLIE: So there are structural impediments there - I mean, because there can be all sorts of intermediate things which aren't necessarily embedded in rights given

to retailers versus distribution versus the chain. There can be problems; there may be no gas available at this stage et cetera, but, in essence, is there any reason why one of your larger users can't then go into play with a direct access agreement, dealing and then taking the charges as they go down? In other words, it's the true nature of what third-party access is meant to be about, and bypass the retailers. They're not really retailers. They're mega wholesalers, some of your larger users.

MR LIM: I think you're right about the structure impediments.

DR FOLIE: But we haven't had any representation about that as an issue, so is it an issue or not?

MR LIM: I'll take that on board.

MR HINTON: Let's move on to issues of coverage, and I suspect we have a thematic approach to this morning's discussion, in that what has been emerging in areas of tension in previous topics will probably emerge here as well, so let's see if it can be more productive. That is, if you've got a regulatory regime and if you make a judgment that it should not be generic to the sector, you then need coverage criteria, so the prior question becomes: given your views on natural monopoly characteristics and the existence of market power, doesn't it follow ipso facto that you would remove the need for coverage and apply the Gas Access Regime to the sector as a whole?

MR LIM: Can you repeat that last bit?

MR HINTON: If you accept that there are natural monopoly characteristics with market power, and that that exists generically for the sector, does that not lead you to the conclusion that you do not have to have coverage criteria because you don't need to make judgments about whether intervention should occur because it should occur - should all infrastructure in the gas sector.

MR LIM: I see. Well, I think, chairman, we did make the point to you either in discussions some months ago or in one of our submissions that we recognise that there are some pipelines where you simply don't want to regulate, (a) because they're too small, and (b) where the benefits probably don't outweigh the costs of regulation.

MR HINTON: But is it only in the small ones that you make that - - -

MR LIM: Small ones or in particular circumstances where - - -

MR HINTON: What sort of circumstances?

MR LIM: Circumstances where there is a highly competitive gas sector. I think we sought to point out that in areas where the market structure is such where there is not a mature gas market that is competitive, then there clearly needs to be regulation, but again I'd like to turn the onus of proof to the Commission to tell us under what circumstances where market power does not apply or are constrained that regulation does not need to be undertaken, and again I go back to one of my propositions, that the draft report has not provided cost-benefit analysis or arguments or even case studies to back up some of its major assertions.

MR HINTON: So your point is - are you right? I'm comfortable.

DR DWYER: I was just going to say, obviously you wouldn't regulate a pipeline built entirely on someone's own land. For example, suppose somebody has 100 square miles and there's a pipeline in one corner of his block and a steel plant in the other corner of his block. It's his land, no public interest is involved; he can do what he likes with his pipeline.

MR HINTON: So, Terry, you put particular weight on this erosion of property right in that particular example?

DR DWYER: I do think the property rights question is fundamental to the whole argument.

MR HINTON: Yes, and that underpins some of your other comments about rates. We understand the origins of that thought and that conclusion.

MR LIM: And I must say that the current coverage criteria that is in the Gas Access Regime allow cost-benefit analysis to be undertaken as to whether particular pipelines should be regulated or not.

DR DWYER: And, see, this cost-benefit thing ties in with the question of landownership because where you have 100 square miles and one person owns it and there's a gas field in one corner of the site and a steel mill in the other, all those costs are naturally internalised by the one owner, but once you have pipelines crossing different parcels of land and if you cannot rate the land serviced and other people to help pay for it, or that's what you've chosen not to do, then you really have to do social cost-benefit analyses, and there is a presumption then in favour of regulation unless the game is not worth the candle and you're satisfied that it's a trivial issue.

MR LIM: And I must say, in defence of criterion D, which is the public benefit test, it is a test which looks at economy implications, impacts, as opposed to a narrow focus on - - -

MR HINTON: As interpreted by the NCC, not contrary to the public interest, that test is used as a cost benefit, and to the extent that they can do that is a challenge, but the argument we put in our draft report is: let's make that explicit, let's not hide an efficiency test in a "not contrary to the public interest" test. Let's say what it really is meant to be in the minds of the NCC as they interpret it. Doesn't clarity and transparency have some ring to it?

MR LIM: And I think the courts in the Western Australian Epic case have actually defined public interest, too.

MR HINTON: Well, it's a negative test and you're not covered if you fail the not negative. It's not a powerful test, that one. But if I heard you correctly and interpreted your comments correctly, you're saying that EMRF are comfortable with the current coverage threshold.

MR LIM: I think I prefer to put it - as you didn't want me to put words into your mouth, I think I'd rather - - -

MR HINTON: I was obviously trying to put words in your mouth. I'm open, I'm transparent.

MR LIM: I think I would rather phrase it as follows: we are not comfortable; in fact we are opposed to the proposals being put forward a la the substantial and material tests, but at the same time we are comfortable with the current coverage criteria use in the current access regime.

MR HINTON: That suggests to me, given that the material threshold - and we're using shorthand here - the material threshold is not that different in terms of height with regard to the current threshold of promoting competition, and there is some debate about interpretation, but generally speaking they're pretty close. We imply, or if not explicitly state in our draft report we think it's probably a little higher than promoting competition, but I read your comments to be that because that sets up the monitoring regime as opposed to the cost based price regulatory regime, that is the source of your objections to the threshold for coverage, rather than the material point itself.

MR LIM: The concern really is that the courts like to be very precise about terminology and words, quite different to policy economists or economists, and that the draft report's draft recommendations stands the very high risk of tying up the interpretation of its words, of material, substantial, and what have you, in the courts and, chairman, I don't think anyone likes to spend the next five years in the courts going through interpretations of words like "substantial" and "material". If I'm not wrong, the Australian Government Solicitor was I think quite hesitant, or certainly

that was the way I read it - some hesitancy about the definition aspects.

And I might add, too, that in the last five years of the operation of the code, there has been a lot more clarification in the courts of some of the terminologies and the provisions of the Gas Access Regime. My biggest concern is that you are introducing a whole bundle of provisions and clauses which stands the risk of sending us all towards the courts again, and it may well be that your prediction that the costs of regulation might be very high might actually bear fruit.

MR HINTON: You don't think this has all the flavour of seeking to scare the horses? Shock, horror, we're going to be tied up in court for years. Surely there is capacity for public policy to be delivered that brings precision to intent that provides guidance for the courts. It's where the words are imprecise and conflicting that leads to judicial uncertainty; the thought that the process of tidying up does require change but in itself can bring benefits.

In terms of "material" and "substantial", couldn't a very persuasive argument be put that there already is a lot of literature on "substantial" and that the only time the "material" has been interpreted as possibly meaning "substantial" is when "substantial" is being used, or "material" is being used in isolation. As soon as you put the two together and flesh out the fact that "material" is less than "substantial" and the policy intent to have thresholds that apply with different force in different circumstances, that in itself should address the scaring of the horses, that legal eagles will be running amok.

MR LIM: And, as I say, the ultimate test is probably in the courts, and rightly so, and I'm not a legal expert. All I can point to would be the information that Allens Arthur Robinson, the large law firm, which has on their web site - - -

MR HINTON: Substantial law firm.

MR LIM: Yes, a substantial law firm - a large law firm, a big law firm, with a very large practice, with many solicitors and lawyers - there you are - have on their web site some concerns about that particular issue, so it's not just Bob Lim and EMRF speaking. I think we are talking about a lot of lawyers that are making those same points too.

MR HINTON: Just excuse me, Bob, don't misunderstand me. I am not in any way challenging the view that it's important that if we have a regime that has material and substantial construct that we seek to add as much precision to that construct as we possibly can. That's not at issue from our perspective.

MR LIM: Okay, yes. I would add that it is the onus of proof that is on the

Commission to establish that the current tests have not worked, that the operations of the code have been significantly costly, compliance costs have been costly, and that the costs outweigh the benefits and therefore there needs to be changes to the coverage test.

MR HINTON: We come back to the thematic approach, yes. Terry, did you want to add something?

DR DWYER: I just wanted to make a comment on substantial material. I noticed the legal opinion from the Australian Government Solicitor, from George Wotinski and Jane Higgerson and their comment that according - depending on the context in which it's used, "substantial" may mean the same thing as "material" and - - -

MR HINTON: That's selective quoting, Terry.

DR DWYER: I know, but what I'm driving at is they gave a very - on the one hand, on the other, opinion which wouldn't give me much comfort as a legislative drafter to put that in - - -

MR HINTON: Can I beg to differ; that was providing important words to guide us that we do make a distinction between the two and put them in context, because of the history of when material was looked at in isolation, and that is the origin of that particular statement by the legal advisers. It reinforces the point that I think you've both been making, that if you have a Gas Access Regime with two different thresholds with those two words, irrespective of the words, it's important that you flesh that out to make the policy intent as clear as possible. We're not disputing that; in fact we're endorsing your remarks, as others have also made.

Let's move on to the monitoring regime. I know it wouldn't be in your regime, but we still welcome your comments and in particular it's to do with - and this has arisen in discussions with some other interested parties about - and why I'd welcome your perspective is whether or not a regime that has a monitoring framework can be effective in influencing behaviour, because at the end of the day the idea is that is the intent of having that tier of the Gas Access Regime as constructed in our draft report. You seem to read it as carte blanche to gouge. The question is: does not a monitoring regime provide a basis to provide some confidence that behavioural traits, behavioural practices will be influenced?

MR LIM: I guess if companies or company directors don't seek to maximise profits, as a shareholder I'd be very, very concerned. So my response to your comment is that if I were running a monopoly pipeline business and I am faced with a monitoring option, given the nature of short-termism within the corporate sector, I would gouge. I would maximise my returns - so that is one point. The second point

I would make is that the airports monitoring case does support our concerns that once you move to a monitoring option that the ability, the restraints that might otherwise have been operating by way of regulation, may mean that prices do rise substantially. We have a number of other concerns, too, which we have raised, and that is there has not even been a mechanism suggested as to how - if monopoly rents or gouging were to happen after five years - what might be done immediately to address that issue.

Let me say that it may well be that some of the downstream industries may no longer be operating in any case, if they were faced with a 40 or 60 per cent price rise in a period of - firstly, of the monitoring option as you pointed out. Do you want to add something to that?

DR DWYER: Yes, I'd just like to say monitoring seems to me to be adding insult to injury. Why do you feel better to have some public method of showing how you're being screwed? Every time I get a taxi from Canberra airport and pay $2 for using what was once a public road, I curse the people who are responsible for it. It's a tax.

MR HINTON: And Melbourne and Sydney.

DR DWYER: Yes, exactly. It's a tax. These are taxes. We've got to realise this is tax farming. These are costs being imposed on the internal trade and commerce of this country. We have to come back to this fundamental, that all economic progress from the Middle Ages to now has rested on the annihilation of time and distance and improvements in transport. What we're talking about here are highways. They are things which are necessary to transport a commodity from one place to another so that it can be used. Anything that allows the cost of transport to be driven up is as counterproductive to trade or commerce as closing the Suez Canal or the Panama Canal, or getting rid of the trade routes to India and sending us back to the days of the caravans and the Silk Road. If we want an Australia-wide economy across a continent with the population broken up into 20 million people in several cities, we have to make sure that we keep our internal transport and communications costs low. Basically, if we don't, then we will lose businesses and jobs.

DR FOLIE: I'd like to ask Bob the question in a slightly different framework. It's a monitoring regime, but then if the assessment of the monitoring is that they have been doing what you're saying - price gouging - there is actually - they revert back to the detailed onerous system, so it's actually not unconstrained. You're in there to make hay.

The other proposition is that a dispute whether or not shareholders - this is often directors who have the responsibility to maximise profits. They actually - I think if you look at most of the literature it would say that they are to maximise, if

you like, shareholder value. Shareholder value means that if you can get some high profits in one or two years and do something horrible and destroy the company, that is not in line with their duty. A lot of their duties are about actually - the integrity of the assets, the ongoing ability to be able to generate income. So they are, in some way, therefore tempered in how they might perform. Does your question still believe they would actually gouge in five years, given those duties?

MR LIM: Terry will comment on that.

DR DWYER: I'll comment on that. Take a look basically at the short-termism issue that Bob raised. When you look at shareholder value, what people tend to do is extrapolate and capitalise the latest revenue stream. If I were a director of a deregulated monopoly I would gouge. I'd try to be discreet about it, I'd try not to upset the horses too much. I'd try to do it in death by a thousand cuts rather than one thing that will get in the Sydney Morning Herald the next day, but I want to ramp up the cash flow to this enterprise as fast as possible so I can get a good price earnings multiple on the stock exchange, and I will get my remuneration package as managing director tied to the short-term performance of the share price and if there's reregulation five years down the track, it's not my concern; I've parachuted out with my golden parachute.

We've seen it with AMP. We've seen it with a lot of companies where people who have done absolutely abysmal things with assets in terms of long-term shareholder value have walked away with millions of dollars. That's their incentive. Their incentive is not the public interest or even the long-term interest of the institution they're running. Their incentive is to walk away with the cash. Why wouldn't that happen with a public utility? As the ACCC pointed out with the airports, if I was smart about it, I would make sure that I could turn around and say, "I'm not making profits because I've overgeared to an associated stapled entity which is stripping it all out as interest," so I can appear to be virtuous and appear on camera with a straight face saying, "This airport corporation, or whatever it is, is not making outrageous profits; in fact, we're very marginal after all our costs."

I would mutter under my voice, "Well, of course, those costs are interest payments to our associated stapled entity which is paying handsome distributions to the stapled unit holders." Fine, you know, that's the game. You strip it out.

MR LIM: And, Michael, your assumption that the threat of regulation after five years is shock, horror and collapse, just doesn't hold true. I don't think regulators are in the business of regulating companies so that they go out of business.

DR DWYER: And wait until you come back and government tries to reregulate and your securities have been sold to a lot of superannuation funds who are coming

down the minister's throat saying you are about to wipe out the savings of widows and orphans. Once you've created these horrendous tax farming monopolies, floated them on the stock exchange and people like me have invested in them, you cannot get rid of them.

DR FOLIE: Just for the record, I didn't actually say that the regulators redeem them, they put them out of business - it was a much more onerous form of regulation. That was all I was saying.

MR LIM: Okay.

DR DWYER: So once the gouging has taken place it will be capitalised, it will be sold and bought on the stock exchange and super funds will all be involved.

MR HINTON: The proposals in the draft report put forward that this monitoring regime is not applying across the sector that currently is subject to cost based price regulation; it would apply to those where cost based price regulation is not warranted. That's a judgment about thresholds and therefore the overstatement by Terry that this monopoly would then rip it off and behave that way is not attacking the proposal; it's putting forward a case that we say would not apply under our monitoring regime. It then becomes a debate about the threshold.

DR DWYER: But I'm a bit confused. I thought the presupposition would be that - would a monitoring regime discourage you from gouging, which assumed that they had the power to gouge, therefore we were simply saying yes, of course they would, and they'd try to distribute the profits of the gouging as widely as possible.

MR HINTON: And in circumstances where they have that market power to do so. Under our construct it would be judged as to not be in that characteristic - that is, there would be matters of degree. It's not a black and white example that there is monopoly power, full stop. Therefore if you monitor them, they would act a certain way. The argument is that if you are not in that monopoly position but have certain characteristics that you should be monitored - that is, our lower threshold - then whether or not that arrangement would lead to behaviour to be constrained, in circumstances where if you did then start to seek to do certain behaviour contrary to the intent of the Gas Access Regime, you would then be subject to the potential for being put in the other tier, the cost based price regulation. That was the question.

DR DWYER: If I'm being monitored and I don't have monopoly power, I can't gouge. If I'm being monitored and I do have monopoly power I will use it as much as I can and go for it. That's the short answer to the question. You're assuming that the only ones being monitored are those who aren't worth monitoring, I think, aren't you?

MR HINTON: No, there's a matter of degree. It's not black and white circumstances - you either have monopoly power or you don't have monopoly power - it is a range of market power. At that end, sure, cost based price regulation; this end, uncovered; in the middle you've got this monitored section.

DR DWYER: I think as economists and investors we can say that a business will rationally try to go for whatever it can get.

MR LIM: It's rational behaviour.

MR HINTON: And good luck to them; that's their job - if they're allowed to.

MR LIM: I should say that if those businesses do behave rationally then the downstream industries or the customers at the end may not be around in five years' time to go to the regulator and participate in any regulatory review. Because I can assure you that their international competitors, or there other competitors are not going to give them a five-year access holiday or competition-free holiday.

MR HINTON: Michael, how are you doing?

DR FOLIE: I'm right, thanks.

MR HINTON: Okay. Bob and Terry, what have we not covered that we should have covered this morning? Anything you particularly want to pick up that we haven't done by discussion or by introductory remarks?

MR LIM: Yes. Chairman, I made a number of presentation points in my earlier introduction. I made in particular a number of points where I pointed out the absence of analysis or assessments in the draft report of overseas experiences. I pointed in particular to the question as to why in the United States, which has a mature gas market and has at least 300 pipelines, some of whom compete with each other - why there is such a strong regulatory regime. I think it's beholden upon the Commission to investigate that issue.

I also made, in my earlier remarks, that we had raised in submissions the experience of lighter-handed regulation in the UK, of the gas market. We pointed to results which appear to show that monopoly rents were cranked up as a result of that lighter-handed regulatory approach in the UK. Again, we ask the Commission that it surely must look at the experiences in the UK as we have pointed out. We still maintain that the analytical framework that the draft report has taken is only a partial one. It has failed to look at the wider issues of public interest and the economy-wide impacts of access regulation. I leave my remarks at that.

DR DWYER: I would just like to say I think this is a very interesting report because it has raised fundamental questions about the nature of monopoly and what it means, and what you mean by economic efficiency. That is why my remarks have focused so much on what is the underlying model, because I think it's crucial. I'd just like to mention that we've been so interested in this that Bob and I are thinking of reworking our paper and submitting it for publication because we think this whole question of when you regulate and not, and natural monopoly, is crucial and you can only understand it when you understand what is a monopoly. If I have one plea it would be when you rework your paper, please try to define your terms as carefully as possible and set out your implicit analytical assumptions so that a reader can work out what exactly is behind the model. I think that would be very helpful, for all concerned to come to grips with it.

MR HINTON: The question welcomes public debate on these issues and more widely. Thank you again for your substantive submission and your participation today and previous participation. It's appreciated.

MR LIM: Thank you very much.

MR HINTON: We will take a morning tea break and return here at 11 o'clock. Thank you.

MR HINTON: Welcome back to the Sydney hearing of the Productivity Inquiry into the Gas Access Regime. I now invite representatives of the Australian Gas Light Co, Mr David Pringle and Mr Alf Rapisarda, to the microphones. Welcome. It's a pleasure to have you here and I invite you to make an introductory statement to set things off and running.

MR PRINGLE: I'm Dave Pringle and I'm the regulatory affairs manager for the gas networks for AGL. I have with me Alf Rapisarda, who is the acting general manager of energy networks. We would just like to start out by thanking the PC for the opportunity to make this statement here today. What we'll be doing is basically running through AGL's submission, which very closely followed the format of the PC's draft report, so we'll be more or less running through that report. We're happy to take questions throughout or at the end, however you feel fit. Largely, AGL welcomes the findings and the recommendations in the draft report. We very much support the thrust of what you are saying.

The focus of AGL's concern, having read it, is the need to further develop those draft recommendations. The recommendations are going down the right path but in a number of areas, such as the definitions of certain words - AGL is not going to suggest how it should be done, but we feel there is a need to further develop that so they are not misinterpreted by other people down the track. Really, from AGL's point of view, our number 1 aim is to improve the current access arrangement regulation regime. We believe that our biggest asset, which is the New South Wales gas network, is likely to remain under the heavy-handed regime, in which case we would like to see that regime improved.

In our original submission, back in September last year, we made a number of recommendations which we thought would go along the road to improving that regime. Some of those have been incorporated in the draft report. Others haven't. We will be revisiting some of those later on in our presentation - then just to work through the submission, if you like. Up front we've got the objects, the objectives and the objects clause. AGL strongly agrees with the need to clarify the objectives. However, we feel that it would be more effective if regulators were required to have regard to the objects in carrying out their function. I think the government, in their reply to the Part IIIA review, recommended that and AGL think it would be more effective if something similar was brought into the Gas Code.

AGL supports the proposed objects clause. However, as I alluded to earlier, we feel that the Commission's intent must be clearly understood. As evidenced by some of the debates since the report has come out, some of the words used - "economically efficient, economically efficient investment" - and the possible conflict between the promotion of competition in upstream-downstream market and economic efficiency, we would like to see further work to clarify that so they're not

misinterpreted. In terms of the consequential revisions that flow from those objectives, AGL basically agrees with the majority of those. One thing we would like to see retained, however, is section 2.24(a), which is the reference to the legitimate business rights of the asset owner. We believe that when the Gas Code was introduced that was put in there because the asset owners at that point in time lost a significant property right and we don't believe that now that charge should be taken away.

In terms of coverage issues, again AGL welcomes the finding of the coverage being invoked only where it improved economic efficiencies significantly and we strongly support the threshold test. However, a bit like the definitions I spoke about earlier, it is critical to have the appropriate definitions and it must be clear the intent is that there is a large increase in competition. Whether the right words are "material" or "substantial" we don't know, but the outcome must be that a large increase in competition - "large" is not the right word either - is put into practice. One other thing which we put up for consideration is where we talk about "are likely to have" increase in competition, it could be misconstrued to mean, "just possibly" increase in competition. We would prefer it if a stronger test - "will have the effect of increasing competition," rather than just "likely to be"; on the basis that "likely to be" could be interpreted as being very weak.

Moving on to the monitoring regime, again AGL appreciates the intent behind the proposed monitoring regime. However, we do have a concern that if the monitoring regime is seen as the Commission's major response to the deficiencies in the existing access arrangement regime or the access arrangement tier - if that is the major response, AGL has a real concern that a large part of the gas infrastructure industry won't benefit from this review of the access regime. AGL's chief concern is for an improvement in the heavy-handed access regime approach which is currently in place. Having said that, we do see that there could be significant implementation issues with the monitoring regime.

Again, I mentioned this earlier: the definition of "material" and "substantial" appears to be open to debate, and there's a real question of how intrusive the regime will be once it is brought in. Is it going to be a light-handed monitoring or a heavy-handed monitoring which could be interpreted to be basically a replication of the current information requirements we have in the access regime; other than that it just won't prescribe the prices for the next five years. You might have to go through that whole process to prove that your prices are reasonable.

Another issue is that - and this hasn't been alluded to by the Commission but some other people reporting to it - if the access arrangement regime is seen to be just a punitive measure for those regulated entities that are seen to be bad, that could be turned around so that it's seen to be acceptable that the conditions, once you get into

that regime, become quite punitive - if you follow what I'm saying. We don't want to see the access regime seen to be a punitive measure because a number of asset owners will be in that category, not through being bad, just because of their size and their market power; not through exercise of market power. So there must be a reasonable regime for those asset owners.

Another point with the monitoring regime is that these are just transitional issues. AGL is not clear how we will progress from our current position to the monitoring regime, whether all the assets are going to go into where they currently stand and then they'd have to apply to go back to the monitoring regime or vice versa. So depending on how that is handled, there could be quite a volume of work with assets going either in one direction or the other. I suggest that is addressed in your final report. Moving on to access arrangements, the draft report recognises deficiencies in the existing cost based regulation, but we don't believe it is followed through with concrete proposals for reform. There are some, but we think it could go further.

AGL agreed with the recommended changes to section 8.1, Pricing Principle, but these principles alone may still allow a narrow regulatory focus on efficient costs recovery. Assuming again that the larger assets, such as AGL's gas distribution network, remain covered by the access arrangement regime, that regime must be made more effective and we believe reform is required. To address that, AGL put a number of suggestions in its original submission back in September. I'll just run through some of those. One is that on the rate of return AGL recommended that where the determination of WACC was deemed to be appropriate, there would be an independent panel of experts, if you like, to determine the parameters that go into that calculation, rather than each regulator forming their own view as you go around the country and go around in an ever-reducing circle. We would like to see that revisited.

In terms of cost recovery, all the large businesses have been through a number of cycles - we're going through our third one now - of pricing reviews and we have been incentivised over that period. We believe the regulated businesses have been, and will be in the future, and need to be in the future given the incentives to determine, just by their own ability to achieve, what an efficient level of cost is for their particular asset and their particular industry, given that state. So rather than regulators determining through various methods what they believe an efficient level of costs are, we believe that the asset owners, by their own nature and by their own activities, will reach or have reached an efficient level of cost. It shouldn't be incumbent on regulators then to assume that the regulated assets that have been incentivised for some period of time are still inefficient and should be able to operate at a cheaper level than what they are at the moment.

Following on from that, what we put forward was an earnings sharing mechanism. We believe that the target revenue should be set within a given access arrangement period, so that the price at the end of the period reflected the actual efficient costs at the start of the period.

I probably didn't explain that very well, but it is in our September submission. Basically, the outcome of that was that there was a glide path so that efficiencies realised over one regulatory period would transfer to customers over the next regulatory period. By doing that, it would give the asset owners the incentive to seek out and take risks, if you like, to become more efficient and pass that benefit on to consumers in the following period, rather than what happens now where the regulators take the view that certain efficiencies should be achievable. It's their view that they should be achievable over the period and they take those efficiencies away before they're even achieved.

Further on access arrangements, on information requirements, AGL believes that regulators have adequate information-gathering powers at the moment under section 41 of the Pipelines Access Law. They have extensive ability to ask not only regulated entities but other parties who may contain information to provide that to the regulator, and we don't see a need for additional powers in that light. The suggestion - floating the idea - in the draft report to standardise information, we're not sure about that one, depending on how that is then taken.

If there is a standard information procedure and it's quite light-handed and it is common across all assets, that would be quite reasonable, but we are aware now that across Australia there are various regimes. Some are very heavy-handed; the one in New South Wales which we operate under we believe is quite reasonable; the regulator uses section 41. We have an open exchange of information when the access review comes around, but we don't have a voluminous set of accounting standards and cost allocation methodologies which are forced upon us, whereas I know in some other jurisdictions they do have. If the intention was to standardise on a set of information-gathering powers which we believed was just not appropriate, we wouldn't want to go down that path.

In terms of lighter-handed regulation, again, we welcome the acknowledgment that there are substantial costs under the existing regime. We support the introduction of a truly light-handed regime, but the monitoring tier must not detract from improvement in the access arrangement regulation. That goes to what I talked about earlier. And, again, what I talked about earlier, the price monitoring regime must be truly light-handed. We believe there's a danger that it may not develop that way and, again, a suggestion that the information required under the light-handed monitoring regime could be included in the access arrangement itself, a bit like attachment A to the current Gas Code, to avoid the regulatory creep and more and

more intrusive regulatory information-gathering powers that may be forced upon the asset owners.

The next section in the report and in our submission was concerning investment and access arrangements. AGL again welcomes the finding in chapter 9 of the draft report. However, we are concerned that these findings do not go far enough and investment in uncertainty will still be an issue. Under the current arrangement, the share of the blue sky from a successful investment project is effectively denied to the service provider, and we don't see that being sufficiently addressed.

In terms of the draft recommendation for binding rulings, we believe that binding rulings as such, as is proposed, would be inappropriate for a genuine greenfield pipeline or network. We believe that there should be automatically long coverage for those assets which are genuinely greenfield. I know there's a problem defining "greenfield", but for those high-risk greenfield pipelines we believe they should be automatically long-covered. The other concern with that chapter is what will happen at the end of the 15-year period, as proposed.

When an investor is making a decision whether to build a pipeline or a gas distribution network, he has a very long time horizon, and you need that or it just doesn't become economical. Clearly, doubts over what's going to happen after the 15-year period will have a major impact on your decision to invest or not now. It's rare that you get an adequate return within that 15-year period, so doubts over what's going to happen after the 15-year period are still of major concern and could dampen investment in greenfield pipelines.

The proposal about truncation premium: I guess our concern there is we didn't really understand how it would be calculated, when it would be applied, whether it would be applied to genuine greenfield pipelines or all investment. So I would like a bit more clarity on how the truncation premium is to be applied.

Moving on to some of the more administrative matters - associate contracts - AGL welcomes the recommendations that associate contracts for reference services do not need regulatory approval. However, in both of our submissions, AGL put the point that it should only be reference services that don't need regulatory approval; that that should only need to be notified to the regulator. The easiest way to describe it is to look at gas networks. Gas networks in New South Wales, we have basically per customer pricing, depending on not supply but on the delivery point, and when we make an offer it's really an offer for pricing conditions specifically to each delivery point. We make it known to that end consumer that he can go to any supplier and get those same network conditions.

So there may or may not be a reference tariff, but the end consumer can go to an AGL retailer or Energy Australia or any other retailer and get exactly the same terms and conditions. We believe that where those conditions apply, that it's for an end user and the end user can source those conditions from a number of parties, not just a related party. There should be no need for approval before the contract is entered into. In our experience over the last few years, that's where the majority of our administrative work has been - in getting those contracts approved.

The other issue in associate contracts is that we believe it should be made clear - and I think the current code could be read, or has been read, in two different ways - that associate contract provisions clearly only relate to the provision of services provided by the pipelines, not for the provision of services to the regulated entity such as a maintenance contract or a capital expansion contract.

On asset management contracts, this is a significant issue for the industry and for AGL in particular. We believe that in our submissions and elsewhere we've shown that this is an area where there are significant possibilities for future second wave of restructuring, a second wave of efficiency savings within the gas industry. But that won't happen if the regulation is such that there isn't an incentive for companies such as AGL and others to go down that path. If there's no incentive to do it, companies won't take the risk to restructure and the possible improvements just won't be achieved.

We believe that there's adequate power in the code to obtain information held by the asset owner, so we don't believe there's any further requirement for that. Under section 41 the regulator can ask any service provider, not just your related service provider, for information and we don't believe there's a need for any additional ring fencing issues because a related asset manager or any asset manager is already bound by the ring fencing provisions within the code.

On administrative issues and appeals, AGL welcomes the findings on importance of appeal rights; its importance for transparency, accountability and predictable decision-making. I think the ACCC yesterday alluded to the same thing - that the appeal rights were something that they considered all the time when they made their decisions. So that re-emphasised, if you like, the importance of maintaining and strengthening appeal rights. On the timeliness proposals, it's important for the code to allow regulators to extend time. I know there's a suggestion that that be limited, but they are important decisions and, as an asset owner, it can be very critical to that business. We don't believe that the regulator should be restricted, if taking an extra month or an extra few months would come up with a better decision.

In terms of backdating decisions, as suggested in the draft report, we think

there are real practical problems in doing that. Again, if you look at the New South Wales network and the way our pricing works, our pricing structure is very complicated. Most of the 500 contract customers virtually have a specific price for each contract and there's complex costing analysis to do that. If we had to backdate tariffs for 12 months, six months or even a few months, it would be very awkward. I don't know how practically you could do it.

The 21-day deadline on new ministerial decisions is again mentioned in the report. AGL doesn't believe that is appropriate. The reason for that is that, again, the importance of those decisions means the minister needs to have adequate time to make those decisions. If the minister hasn't got that time or hasn't got the time to adequately consider it, the decision-making power really falls back to the body who recommends it. We don't believe that's appropriate.

On removal of the further and final decision, AGL doesn't have a real problem with the removal of that further and final decision. Again, from a practical point of view, there has to be some step in there so that after the final decision - again, in a network environment anyway - there is quite a bit of complex analysis to put that into an access arrangement itself. So there has to be a further final decision as such, but there has to be a verification by the regulator that the asset owner has done the right thing in terms of putting the final decision into play so that it has to come back to the regulator in some way but it doesn't need to be in the form of further and final decision as we've currently got.

Having said that, if it just becomes an approval process as such, we don't have a problem with the further and final decision being removed, but the other issue with that is, if that does happen and there is an appeal, it does limit the ability of the asset owner to present information to that appeal. So especially where there's new information which is brought out in the final decision or new decisions, if you like - brought out in the final decision by the regulator - if the asset owner doesn't have the ability to present new information to counter that, they're at a disadvantage. So we believe in principle that the issue of removing the further and final decision is not a problem in itself, but there are some practical things that need to be addressed in that. AGL agrees that the limitations on the grounds for appeal should be removed. In relation to the institutional arrangements - I'm getting towards the end.

MR HINTON: No problem.

MR PRINGLE: We're all aware that the Gas Code review is going on. At the same time there is a review of the MCE process, there's a review of the national regulator, especially on the electricity side of things. They seem to be doing that first. But we feel it's important that at some stage, and before they're actually implemented, the gas regimes and the electricity regimes come together. We don't

want a case where, despite what's happening with the Gas Code, a lot of the rules are established by the developments in electricity. Gas has to accept developments that have been considered in the electricity side of the thing which may or may not be appropriate in gas, so there needs to be a convergence of the electricity review process and the gas review process before it becomes too late.

Again, just on institutional arrangements, it's critical that new arrangements provide a better code change process. The separation of the code change decisions through administration, again, is essential. We believe the industry based body needs to be involved to develop proposals for the code changes. It is critical that appropriate transitional arrangements be made so that there is sufficient industry consultation in whatever the transitional processes are that are put in place. That's the end of what I was going to say.

I'd just like to sum up again with what I said earlier: that AGL welcomes the report. Despite the criticism I've been talking about for the last half-hour it is very supportive of the thrust of where the Commission is coming from, but there are a number of areas where we think we need to go further. Most of them aren't a change of direction from where you're going, but you just need to take it a bit further and define things. In particular, we want an improved - what we might call the heavy-handed tier, or the access arrangement tier and we don't see substituting the price monitoring regime as a substitute for improving the existing regime.

MR HINTON: David, thank you very much for that. Thank you also for your submission. This one is a very substantive submission, as always from AGL, so it's not just thanks for this one, but for your previous submissions. They go directly to the issues before the Commission. We appreciate AGL's involvement in this inquiry.

Your introductory remarks were quite full and therefore obviously they've anticipated many of my questions, and that's not surprising, but there are a couple of matters I wanted to react to, but also seek elaboration on. Let me react to your point right up-front regarding the objects clause. You referred to the government's response to the Part IIIA review which included a recommendation, or in fact a decision that the regulators would be obliged to take into account the objects clause, and that is not in our draft report and we think, for example, that's one example where we really appreciate your input, because we agree with that point in fact. If you're going to have an objects clause, then an overarching objects clause, it's important to have it have impact. So thank you for that.

We also particularly note your emphasis this morning on the need for the Commission, in moving to a final report, to flesh out and elaborate in clearer terms the meaning of and intent of words that we're seeking to apply to a revised Gas Access Regime such as "material" and "substantial" and "efficiency". I think we

have an intersection of interests there. You raised also this morning this question of transition. How do you implement what we've proposed relative to where we are today with the existing regime? That's a very valid consideration. We've got different views from different interested parties on that. Some have argued that if you're going to have a monitoring regime all should be in the monitoring regime automatically from day one. I mention as an aside that representatives of the transmission sector said, "Definitely transmission should be in the monitoring regime because the circumstances of transmission are different to distribution." Then the distributors came along and said exactly the same thing with regard to the distribution system - surprise, surprise.

There are issues of transition, and so one of my first questions related to this is: are you comfortable with our conclusion that a single Gas Access Regime for the sector is appropriate; that is, not seeking to have different systems for distribution and transmission?

MR PRINGLE: Yes, we do believe that one access regime is appropriate for the two sectors, but there has to be allowance for the differences in the two sectors in doing that. The differences aren't that great that you need to have two separate codes, if you like. Enough of the provisions are common that they could be incorporated into one code, but it needs to be flexible enough, or subsections within that, if you like, that clauses might only apply to transmission or distribution.

MR HINTON: Yes.

MR RAPISARDA: If I could just give one example. Generally the principle that both types of assets are covered under the code is fine, but there are some practical differences between the assets and, for example, determination of spare capacity is one where the code as it's currently written makes sense for a pipeline, but doesn't make sense for a network - as long as those things are taken into account.

MR HINTON: Thank you for that. But if there is this issue of transition - that is, getting to another tier, the monitoring tier - and if it's not automatic that a particular segment is in the monitoring tier, then you need to have a methodology to move from cost based price regulation tier to the monitoring tier and vice versa - that is, uncovered to covered, whatever. We've put forward in the draft report implicitly that there would be case-by-case assessment, which has led to some suggestions. Implicit in your comments that AGL would start out as cost based price regulation tier, suggests to us that you are implicitly endorsing what is in our draft report, that there be case-by-case assessment as to which particular tier would apply to each particular infrastructure.

MR PRINGLE: Yes. Having said that, that's not an acceptance by AGL that we

believe we should be under that regime. That's just a practical realisation that we are likely to, I guess, is the - - -

MR HINTON: I understand the distinction. Thank you.

MR RAPISARDA: While accepting the fact that the case-by-case analysis analogous to a coverage determination is likely to be the case, we see it as a very expensive and resource-consuming way to get there and certainly it would be open to other methods if they were available.

MR HINTON: Thank you. The difficulty with category decisions as opposed to case decisions is it raises the possibility, in effect, that you have the potential for regulation to apply inappropriately, or regulation not to apply inappropriately, but each carries its own costs relative to benefits. We're looking at those issues.

I wanted to also pick up, in your introductory comments, David, this reference that you don't want the cost based price regulation tier to be seen as a punitive mechanism. I think my recollection is that that is the first someone has raised that with us, but in fact I understand where that's come from, because we've talked about - even in the public hearings - the point that if misbehaviour occurs under monitoring there is the threat that you would be removed from that monitoring to the heavier-handed regulation. That implies a quite pejorative flavour to it of punishment. In fact, we have to be conscious of that when we move from draft report to final report. That is not our intent. We would like to see it as not about punishing behaviour, but ensuring that the regulatory structure being applied to the infrastructure is appropriate for that market structure. That's a very different flavour to one of punishment.

MR PRINGLE: That's exactly where I was coming from. We didn't read that into your report, that it was meant to be punitive, but exactly the thing that you quoted. We've been aware of that sort of thing and we didn't want it to be seen as punitive or - - -

MR HINTON: I think it reflects probably my own shorthand terminology, that has given that impression. I think I should be careful in further hearings down the track, so I appreciate you raising that point.

MR PRINGLE: I hadn't got that impression from the PC at all, more from other industry - - -

MR HINTON: That's good. I've got a whole range of questions, but let's stay with some reactions to your introductory comments which I found useful, and that's this question of greenfield pipelines. I've jumped ahead of the game a bit. Can you give

me a definition of a greenfield investment proposal? I'm surprised you raised the question - put it that way. My starting point was that - it's a bit like truth, "I know", or "I know what I see". No, that's a bad example.

DR FOLIE: We were given pornography yesterday.

MR HINTON: I was trying to stay away from the pornography analogy. No-one from the industry, other than yourself, has raised the question, "What does the Commission mean by 'greenfield'?" My recollection is that I don't think it was raised in the Parer report process either. The fact that you raised it in itself is of interest, so I want to explore with you more your unease about what is the concept of greenfield.

MR PRINGLE: Again, I come from a network background and the greenfield is more of an issue on transmission than in network; I know that. But in distribution I would think it's very grey in terms of what is greenfield. As we've developed the distribution system throughout New South Wales, we would have described a country town, where we haven't had gas before - we would call that greenfield.

MR HINTON: What about a different suburb in Canberra?

MR PRINGLE: We don't call that greenfield, but they are very similar in nature in terms of the distribution business and the risk that you take. The only difference is where they're located geographically and there's not a lot of difference within a distribution system between going to a new suburb as opposed to putting a main down in a street in an existing suburb. Most people can see a new pipeline to a new part of Australia as greenfield and would accept that. On the distribution side there are lot of shades of grey in terms of what is greenfield and what's not.

MR HINTON: One way of differentiating would be one of project definition. That is, if you've got a project to put gas into Canberra, then it has its own commercial imperatives and funding arrangements and legal responsibility, it's a project, and so whether you go to suburb A one month and then suburb B the second month, the second suburb would be an expansion rather than a greenfield; that's opposed to going to a country town where you actually set up the funding differently, it's a separate project, identification is project approval - project approvals in fact, not only internally but externally. Isn't there scope to differentiate by the question and by the issue of project: what is a project for the company?

MR PRINGLE: I guess I don't want to be the person who proposes a definition of greenfield across Australia.

MR HINTON: You think I'm setting you up, do you? I'm not like that.

MR PRINGLE: Again, I have heard it described that, even within a pipeline, there should be - whether it's greenfield or not greenfield - but those pipelines which go to an area which needs to establish a whole new gas market are in a different category to those pipelines which go to an area where the gas might already exist, who don't have the same risk.

MR HINTON: Yes.

DR FOLIE: I think it was put to us - unnamed state and unnamed group - that there is, I'm not sure, but apparently some discretion, because you can make a decision - only on distribution, on greenfield - whether you decide to greenfield the project, and you set up a definition, or it triggers a brownfield site expansion of the existing network. That's an option the company can try, and then argue with the regulator. Is that also your understanding, that it may be do-able?

MR PRINGLE: I'm sorry, could you repeat that?

DR FOLIE: Greenfields is very difficult to define in distribution because you can actually structure your project to either be brownfields or greenfields, depending on your own interests. In other words, it is greyer in distribution where it's probably clearer in actual transmission.

MR PRINGLE: Yes.

DR FOLIE: I think that's really what you're saying, isn't it?

MR HINTON: A related point is that your submission and your comments suggest that if you're going to have this approach of this regulation-free period of 15 years that it should apply generically - that is to all greenfields, however it's defined - as opposed to a case-by-case judgment. One way around problems with greenfield definition is to have case by case. The definition would become even more crucial if you have a generic regulation-free period, so that is another way of addressing the problems if you do it case-by-case, judgments of market power and prior approval, ex ante, as opposed to ex post decision-making.

MR PRINGLE: I guess - and I don't know how to define this either, but if you get away from the greenfields/brownfields definition, if we talked about high-risk new developments versus less-risk new developments - and I know you can't define that either - those that are very high risk actually having to go through the process to try and get a determination would lengthen the process itself and make it harder at a high-risk basis to get up.

MR HINTON: You didn't refer to the view expressed by some, that 15 years is too

short; 15 should be 20, for example. We raised that in the draft report and 15 years is in our draft report, but some want 20. You're comfortable with 15? Do you have any basis that 15 is better than 20 or that 20 is better than 15?

MR PRINGLE: No. It was AGL's position and it still is - and I know this raises its own problems in terms of how you calculate it - that rather than having a set limit, you have an NPV-type calculation, that when it's determined that the infrastructure has recovered or as a chief payback, if you like, that's the appropriate time that it should become regulated, which might be 15 years, might be 20, more likely longer.

MR HINTON: But that's related to your point that you went on to say: what's going to happen after the period?

MR PRINGLE: Yes, but that becomes less of an issue if the investor has already, if you like, got a payback when it becomes subject to what might be more heavy-handed regulation. Typically I know distribution - I presume transmission is similar - you have a long period - if you took the year-on-year returns, they're quite low. Certainly in distribution that's the case, and it's only after a number of years, often more than 15, more than 20, where you get what might be deemed to be above normal returns.

In a distribution sense that's not too bad because you've got parts of the distribution which are early in the cycle, and parts are later in the cycle, so they wash out, but if you've got an environment where it was regulated separately and you're uncovered for the first 15 years, where you might be making below normal returns - in an ideal world, the below normal returns in the early years would be compensated by above normal returns in the later years, and that's when you need your initial investment, you'd be expecting that, but if you have 15 years or 20 years where you don't achieve adequate returns, then it becomes regulated at whatever point in time, and you lose the ability to get above normal returns at the back end of the project; you'll never be able to get an adequate return over the whole period.

MR HINTON: Well, the issue that you then raise is what happens at the end of 15. Implicit, if not explicit, in our draft, issues of coverage then become operative; that is, it's open for certain parties to have that particular asset subject to regulation because the regulation-free period has finished, and then judgments by - and this is current circumstances - NCC applying the coverage criteria that could either lead to one of three decisions: no coverage, monitoring or cost based price regulation, or that other tier, and that would be done on a case-by-case basis.

MR PRINGLE: Yes.

DR FOLIE: The WACC is an enormous part of - just picking up your point about

the current cost based one, the WACC, I'd like to elaborate a bit further on the idea of an independent panel. Can you believe that - in other words, get another body that would then just work on WACC or should it be logically possibly embedded in one of the regulated authorities, possibly the ACCC? I can see the problem with every regulator around Australia all doing - and we've got lots of papers on the WACC already, just even in this inquiry, but doing that or, rather, put it into one particular entity, but it would no doubt have to have accountability back to government and the groups.

MR PRINGLE: Yes, I would see - whether it's a body or just a committee or whatever, but I would only envisage one, not each state have their own.

DR FOLIE: So within the regulatory environment, the proposal is that one of the regulators would - or there would be a single defined body that would do it and then that would be given, by then, the various regulating entities?

MR PRINGLE: Yes, and within a short number of years, if we had a national regulator, it would obviously be attached to that in some way or other, but I certainly didn't envisage one for each.

DR FOLIE: Thank you.

MR HINTON: In your introductory remarks you referred to costs and the problem of regulators not accepting valid costs in terms of the day-to-day operations of the infrastructure. I'm not sure I can recall correctly the context you put this in but my mind went back to yesterday's appearance by the ACCC before us, who made it very clear from their perspective that as far as they're concerned, they're quite comfortable in accepting the service providers' judgments about what is a valid operating cost.

MR PRINGLE: With transmission, which are the assets that the ACCC regulate, the operating costs are a very much smaller portion of the total cost base than what they are in distribution, so just proportionately for a distribution business, especially New South Wales - we've over $100 million worth of operating costs a year - so the ACCC might not consider it significant for the transmission pipeline but it's certainly significant for the distribution network. But having said that, there are regulators which are now - and I think the ESC is starting to go down that path in Victoria; that they are much more accepting of what costs that are proposed are reasonable. They're starting to go down that path. That hasn't been AGL's experience in New South Wales yet. We're about to go through a review now, but things might have changed. I know the ESC's position has changed over time, too. But our direct experience to date has not been that the regulator will accept your cost as being reasonable.

DR FOLIE: Could I just ask a supplementary on that. Is some of the debate about - particularly with maintenance - doing replacement; in other words, what you're claiming as costs, some of which may be capital and some of which may be operating, and how this then intersects on rates of return? Are you dividing your business activities into capital and operating?

MR PRINGLE: We do do that but in my experience in gas distribution, I think it's fairly clearly understood what's maintenance and what's capital.

DR FOLIE: And there's no dispute with the regulator about that?

MR PRINGLE: We haven't had, no, and I think the gas business is very much different to electricity distribution. There's more of a trade-off between capital and operating costs, and that's a real factor in the electricity distribution, but it's nowhere near to the same extent in getting gas distribution.

MR HINTON: In Brisbane it was put to us that some regulators' approach to acceptable costs was so tight that questions of safety and even engineering capacity on staff were being eroded by pressure to deliver efficiencies that were not really being achieved. Does AGL have any experience to suggest that there's some substance to this?

MR RAPISARDA: We don't have any experience to date but I think that that's our concern, that that's where the existing regime will end up. Ultimately, if there's a continual desire on the regulator to benchmark lower costs, they're really not in a position to make the appropriate decisions about costs and performance trade-off, and that's why we're suggesting that a better regime would be one which clearly has incentive mechanisms for the businesses to discover those lowest costs themselves and that the regulator and the public should have confidence that the incentive mechanisms are sufficient to drive those costs to the appropriate level.

MR HINTON: I'd like you to help us out a bit regarding that. You've jumped some other questions but that's fine. To explain this sort of revenue sharing, sort of productivity process or productivity sharing or productivity benefit sharing that would underpin the sort of incentive regulation that you put forward, what are the sort of parameters of that? It's quite different to the sort of building block approach that is inherent in the cost base price regulation at the moment.

MR PRINGLE: It's a different application of the building block. You still have the same building blocks, if you like, but what you do, instead of trying to predict what prices should be in five years' time, you do your building blocks analysis of what your current cost structure is, rather than trying to predict that the company should be more efficient or should be able to achieve X million dollars' worth of

efficiency savings over the period of time, so your prices are really set based on your current cost. Well, the prices in year 5 - at the end of the period - are set on your current costs, and there is a glide path between what the existing prices are and what your prices will be in five years' time, which you have just determined.

So basically all it means is you still use the building block structure similar to what's used now. You might need to determine the WACC differently or whatever, but it just means that the service provider gets to keep the benefit of the actual efficiency gains that have been achieved for the period of time, whereas at the moment not only does he not get to keep the efficiency savings he's achieved, it's presumed that he's got to choose some more.

MR HINTON: Yes. So ex post sharing as opposed to presumed ex ante. Is that the concept?

MR PRINGLE: Yes.

MR RAPISARDA: Yes.

MR PRINGLE: In this instance we're not saying you do away with the building blocks; just a different application.

MR HINTON: Not different as in total factor productivity approach or - - -

MR PRINGLE: No, that's not what we're suggesting.

MR HINTON: You also referred to, David, legitimate business interests. I don't think you implied we were saying there are no legitimate business interests but that might have been one implication of your comment. Our proposal to amend 2.24 that includes the removal of clause (a) which does flag service providers' legitimate business interests is not in any way suggesting there aren't legitimate business interests. It's a question of whether we needed another listing in 2.24 of a range of factors to be taken into account that have all the potential to distort or disturb the regulator's judgments about what the intent of the regulatory regime is.

As far as you seek to have (a) put back in, others seek to have item (f) put back in, which is the interests of users and potential users. It's not denying the interests of users, it's not denying the legitimate business interests of service providers; it's seeking to have some sort of clarity to the documentation that provides guidance for the regulator as to what the overarching objects clause is. Now, I don't know whether that gives you comfort, but let me try and also add that there is within the pricing principles a principle that relates to long-run return on assets that would seek to identify, at least encapsulate, legitimate business interests.

MR PRINGLE: Yes, we were aware that the Commission believed that the legitimate business interests were encapsulated in the objects and the principles, and it was unnecessary to have that section 224A, as well. I guess we wanted belts and braces, if you like, that we thought because the service providers did use up their property rights when the Gas Code was introduced it is important enough to us to still have that mentioned specifically.

MR RAPISARDA: I guess we have a view that there is a distinction in our mind about the introduction of the arrangements in the first place, which did remove the existing property rights of the asset owners as opposed to creating new rights for the users, so we felt there's not an equal balance there.

MR HINTON: As the devil's advocate some might argue that any intervention, regulatory intervention, by definition erodes property rights of sorts, and to varying degrees, and so if every regulatory structure had to have in it a statement that there are legitimate business interests it would seem to be stating the obvious.

MR RAPISARDA: And also I just note that that comment was also linked to our comment that as it currently stands in the draft we see that there is a need to further link the objects clause to the detail of the principles.

MR HINTON: Yes, and which I picked up right up the front. That's been suggested, yes.

MR RAPISARDA: That's right, so that's picked up and that's less of an issue now.

DR FOLIE: I have gone on while you're looking - is that one of the overarching concerns of everybody at the beginning of this process was really that it was all taking too long and it was all too difficult and part of the shortening efficiency. In other words, that was one of the measures about the ineffectiveness of the regime - was the duration - but it does seem from your submission that possibly you don't appear to agree; that you would rather actually have the process go through its full careful deliberations and you feel that you are prepared to put up with the time difference. That is somewhat different to what a lot of other participants have said.

MR PRINGLE: A lot of the delays to date have been involved around the complexity of trying to determine initial capital base - I know that's certainly the case without network - so I wouldn't envisage that once the initial capital base has been determined for the assets - which they largely have been now - there shouldn't be the overextended delays that we've had in the past. I think what we are more likely to be talking about is not delays of years which I know occurred in some cases, but more likely months and, if that's the case, we would prefer to have a few months' delay

rather than to come up with a decision which is not properly considered.

DR FOLIE: So if I interpret, just summarising, effectively a lot of the appeal processes - the whole mechanism of timing and decision points - you are reasonably content with that in the existing regime?

MR PRINGLE: Yes. We accept that there have been excessive delays - I'm not saying they weren't justified, but there have been extensive delays in the past and I don't envisage that - - -

MR HINTON: That's a bit of "a transition issue". Can I come back to this glide path for sharing out efficiency benefits, productivity performance. If it is done ex post, I think the regulators would argue that that reduces the incentive for the service provider to actually pursue efficiency innovations. If it's pursued ex ante then the pressure really is on the service provider to deliver because, if they don't, then they're in trouble. What incentive scheme would there be for a service provider to pursue productivity gains, efficiency gains if, at the end of the day, they're not going to be having pressure on their pricing levels from the regulator?

MR RAPISARDA: I think under the proposal as we described it, the potential benefits over the five-year period to be retained by the service provider are significant and would drive any rational business to seek those savings. On the other hand, we just think it is inappropriate for a regulated business to be placed at risk of not being able to achieve arbitrary forecasts of efficiency gains.

MR HINTON: Now going to more detailed comments on your submission itself in the time we have got left, in your submission you have put forward that coverage proposals by interested parties should be limited to genuine access seekers; that is, you shouldn't pursue coverage for infrastructure unless you have a genuine interest. In the light of your experience can you give us how one might identify a genuine interest with regard to access in coverage decisions? How would you test that?

MR PRINGLE: I didn't write the submission itself. I wasn't party to that.

MR HINTON: You'll try your hand at an answer, though?

MR PRINGLE: Yes, I'll have a go anyway. I think one test of that would be whether it has been a genuine attempt by the person who has put in the application to seek access in the past. If there has been no attempt by the applicant, if you like, to seek access, I think you would have to question whether it was a genuine attempt for access or not because the obvious thing would be to go for access and talk to the service provider in the first place.

MR HINTON: Fine. You put a lot of weight on trying to bring greater clarity and guidance for the regulators, and therefore the courts, in any revisions to the gas access regime, and you have particularly focused not only in your submission but also in your remarks this morning about the thresholds for coverage decision and therefore the determination of which regulatory mechanism would be enforced - whether it's monitoring or the building-block approach.

It seems to us that there is a fair bit of literature out there, both legal and other, as to what "substantial" means, and the fact that "material" is in juxtaposition with "substantial" and been listed as something less than that, there is significant scope for the intent of the regime to be quite clear not only to regulators but to the judicial process. Do you think that that framework, even if we have to flesh it out more, would meet your concerns regarding this degree of discomfort you apparently feel about this?

MR PRINGLE: There's a lot of literature but I don't know if the literature comes to a consensus of opinion. Again, AGL is not the right body to determine what word should be used.

MR HINTON: But you are not disagreeing with the intent of the proposal so far?

MR PRINGLE: No, no.

MR HINTON: In terms of levels, that's the first step. If we make that clear - - -

MR PRINGLE: We agree with the intent of what you're saying, clearly.

MR HINTON: That's right.

MR PRINGLE: It's just that we're worried that it might not be interpreted the way that the Commission wants it to be interpreted, or intends it to be interpreted.

MR HINTON: You like some others - one other, at least - have expressed some concern about the NCC - including the NCC actually - developing the disclosure guidelines for monitoring. In our draft report we put forward this monitoring regime and say that it's important that the regime have guidelines - and that would be endorsed by you, as you already have - but we put forward the idea that the NCC would develop those guidelines in consultation with relevant parties, and that was linked directly to the point that it would be the other regulator - eg, ACCC and others - that would actually administer the monitoring regime.

It's important to differentiate between those who develop the guidelines and those who actually apply them. We put some importance on that differentiation, but

you have come along and said, "No, don't give it to the NCC to develop the guidelines," and I am wondering what is behind that thinking. The NCC expressed the view that they mightn't have the capacity and the expertise, but I understood the differentiation reason.

MR PRINGLE: Again, I have had no dealings with the NCC, so I don't want to criticise them in any way. It's just that the PC have developed the process of the monitoring regime and I believe that to be a fairly light-handed regime, and AGL supports the PC's comments and proposals on that, in which case, seeing we support the tack you are taking, we would prefer you to be the people to go to the next stage.

MR HINTON: Thanks a lot.

MR PRINGLE: No, we'd like to finalise the guidelines, but at least to give some overarching guidelines, if you like, which might be developed further.

MR HINTON: Yes, I understand the distinction. As an independent advisory body, the PC doesn't get involved in day-to-day regulatory mechanisms, so it is certainly incumbent upon this report to flesh out the nature of the monitoring regime that we're recommending and we will not back off from that, obviously, but nevertheless once it is in place then there is a need to have guidelines there that then could be subject to modification over time and brought up to date, so to speak, in the light of experience. That would not fall to the PC.

MR PRINGLE: No.

MR HINTON: We suggest that the NCC would be the vehicle. That's the distinction, I think.

MR PRINGLE: Yes.

MR HINTON: Michael?

DR FOLIE: I've got two sort of technically-related questions. One is going backwards to when we were talking about distribution, about the losses and then the truncation period, but it has been put to us that the ACCC contend that if you make losses they can actually be cumulated forward and then you can actually get a return, and it's only when you start making so-called "excessive" - after you have accumulated all those losses. I know that you are regulated by IPART, so I'm not too sure whether they follow the same line.

MR PRINGLE: That all depends on how the capital base, when it becomes regulated, is determined, or how the depreciation is calculated, if you like.

DR FOLIE: Yes.

MR PRINGLE: If you were to do economic depreciation, by default, the asset base would just roll forward - would reflect the fact that you've made a loss, so as you made a loss your value of the assets is going up, but I don't believe that there is general acceptance, if acceptance at all, among regulators that economic depreciation is a reasonable approach to determining initial capital base.

DR FOLIE: Okay. The second one is, is there a structural difference between here and elsewhere? In other words, if I was a larger user - a medium-size to large user - and if I could get a contract with someone to give me gas - let's say Santos had some spare gas - could I actually get access through the system pipeline - and we're now talking about distribution - to deliver it directly to me and not have to go to a retailer in New South Wales, or is there a structural need for me to deal with it? Is there something embedded in the legislation - - -

MR RAPISARDA: No. The situation you describe currently exists, so we have customers who deal with us - and consumers who deal with - who are contracted directly to the network.

DR FOLIE: Directly to the network. Thank you.

MR HINTON: I am still on the monitoring regime. You might not have drafted this, as well, David, but you will probably try your hand at an answer. AGL queries why it is necessary for the information to be monitored to be published and this puzzles me, in that an important part of the effectiveness of the monitoring regime is its transparency and accountability and, inherent in that, is some sort of publication of the broad brush trend information that is inherent in the monitoring process and what is being monitored. I therefore wonder why AGL would be questioning the need to publish the information in circumstances where it's a crucial component on the monitoring regime for it to be effective.

MR PRINGLE: Again, you're right. I didn't draft that, but I will have a go. I think that is very much dependent upon the type of information that is required. It comes down to that. If it is broad brush indicators, I don't believe we would have a problem with it being made public, but if it is quite extensive intrusive information requirements, depending on the type of information, whether it's appropriate for it to be published or not.

MR HINTON: I have got one last question and it's to do with institutional arrangements. It may lead to some further discussion because your submission makes something of it and you also referred to it this morning, and that is this push -

for any issues coming out of COAG and the ministerial council of energy ministers - for a national energy regulator. My first question in this area is, is it a correct perception that that process seems to be focusing fundamentally on the bigger sector and to electricity, rather than gas, and the gas sector is more of an add-on? If that is correct, are you concerned about that from your gas hat perspective?

MR PRINGLE: That is our perception, whether it's true or not, but it's certainly our perception. That is what we're concerned about and that's why we raised that at that point in the first place. If the focus on that review process is on electricity, with gas just being added on to the end, if you like, there is a real danger that the gas industry might be left with some inappropriate regulations, regardless of this Gas Code review process that is currently under way.

MR HINTON: But you would endorse a national energy regulator concept, covering both electricity and gas?

MR PRINGLE: Yes. It's not the process itself that we're objecting to. We're flagging don't leave gas out of the thinking process and don't - again, this is not the PC, but the results of the Gas Code review process have to be factored into the broader energy review.

MR HINTON: There is an issue here with regard to role of ministers as opposed to entities beneath ministers, as to which have control of policy change. I think under the construct in our draft report we reinforced the view that at the end of the day if you are going to change the code, then that's a policy change to address with ministers. A subsidiary point, that the entity making coverage decisions should be different to the entity actually administering the regime - that is, NCC versus ACCC, for example. The NER structure seems to be slightly different to that. Is that one area of concern for you? For example, the policy changes potentially belong in a group below ministers, not the NEMC. Is that an area of problem for you?

MR PRINGLE: I don't think I personally can comment on that.

MR RAPISARDO: No, I'm sorry. We'll have to take that on notice.

MR PRINGLE: AGL would have a position on that but I couldn't adequately answer that question.

MR HINTON: A related question is in terms - and I think you picked it up this morning, about the minister making a decision on coverage. We have a proposal in our draft report that says if he hasn't made a decision in 21 days it reverts to the recommendation. You put forward the view that the minister should make a decision one way or the other. There is an issue here that has since emerged post draft report,

as to whether in fact you could operate a judicial process where a minister is obliged to make a decision which then is challengeable under review systems, whereby that minister's decision is by default, by a passage of time, as opposed to saying yes or no.

So in fact I think there already are questions about that particular draft recommendation that I take this opportunity this afternoon to mention to you. We're looking at that again. There are other ways to address the concern by some that there have been extensive delays in coverage decisions. Some suggest one way around it is to have a minister making a statement, if he hasn't made a decision by 21 days then is he seeking more time because of complexity or other reasons. That at least brings more transparency to the process, and we're looking at that.

Anything we've left out that we should have covered that we haven't covered, both in terms of your introductory statements and your submission and discussion?

MR PRINGLE: No.

MR RAPISARDO: No, I think we've certainly covered the territory.

MR HINTON: Let me thank you again very much for your participation both in terms of your submissions but also your appearance here today. It's appreciated.

MR PRINGLE: Thanks for the opportunity.

MR HINTON: Thank you. That brings to a conclusion this morning's session of the public hearings here in Sydney and we'll come back after sustenance, starting again at 1.30. Thanks very much.

(Luncheon adjournment)

MR HINTON: Welcome back to this last session of the Sydney hearings of the Productivity Commission's inquiry into the Gas Access Regime. I am delighted to welcome to the microphones the representatives of APIA, the Australian Pipeline Industry Association. I think we've got Alan Beasley, Anthony Cribb and Euan Morton, is that correct?

MR BEASLEY: That's correct.

MR HINTON: To get matters under way I'd welcome an introductory statement. Then we can move to a discussion period.

MR BEASLEY: Thank you very much, Mr Chairman. APIA, having reviewed the draft report, believes that it very clearly identifies major deficiencies impacting on the long-term development of the gas transmission sector. We believe the report makes very good progress on proposed solutions and that's certainly our view of the matter. In terms of the next steps, we simply make the point at the outset that this report will be of enormous significance into the Ministerial Council on Energy deliberations and emphasise the importance of clarity in drafting a real intent and guidelines to ensure that the true intent of the Productivity Commission final report is translated directly into the Ministerial Council on Energy. That's a matter I touch on in our covering letter, but just wanted to emphasise it here.

APIA views this current review of the Gas Access Regime and subsequent consideration of that report by the ministerial council as the key process that will set the policy scene for investment in an operation of transmission pipelines for at least the next 10 years. I simply make the point that we have some time to go before recommendations from this review are taken forward first through the Ministerial Council on Energy and then subsequently implemented. We believe that will be probably about a two-year process. Subsequent to that, we believe it will probably have standing for about the next decade. I make that point because it encompasses the period when it is generally believed by most market participants that major new supply sources of natural gas are going to be needed in this country - a major new supply source, quite additional to incremental development of spare capacity. So we therefore view a pro-development focus in the work of the Commission as both necessary and appropriate.

In looking at the recommendations of the report, there is a focus on material versus substantial, but we believe the real issue has to be evidence of misuse of market power. We don't dispute the fact that transmission pipelines possess market power. The key issue for us is the evidence that that market power is actually being misused and we have made commentary on that right throughout our submissions. I just wanted to reiterate our support for draft finding 2.1 in the report. I'll come to the caveat in a second but I just wanted to emphasise our support for that overall

recommendation, that transmission pipelines have natural monopoly characteristics; that the market power of transmission pipeline owners is constrained by a number of factors - firstly, the availability of substitutes.

There was a lot of discussion this morning about alternative fuels but I'd also emphasise the competing pipeline dimension which was referenced in your report. Net spare capacity in certain markets, for example, South Australia and New South Wales, in our view shouldn't be taken as a reason to do nothing to the regime. Rather, it highlights the competitive nature that has emerged as a result of non-code pipeline development. So those substitutes are becoming more widely available and that in itself is evidence that the market is changing and competition is emerging. That supports the Commission's overall conclusions. The second point is that size and concentration of users is quite considerable in our industry. We have given evidence in the past that the top five customers for the major transmission pipelines in this country account for around 94 per cent of the gas transmitted.

I simply make that point to counter the point made this morning about the ability of transmission pipeline companies to ramp up rents in the short term under a monitoring regime, because the consequence of that, if we take the user group's conclusion forward, is that they will no longer exist as users and that would mean for those major transmission pipeline companies they would lose in the order of 20 per cent of their revenues. I think that counterbalance is quite significant when you look at transmission operations. No transmission pipeline could afford to lose 20 per cent of its revenue base like that. I think the assertions made this morning are not accurate and don't reflect the market realities we face as a transmission industry.

The third point is the competitive, and I would say contestable, nature of foundation contracts. I think the evidence presented to the Commission to date strongly shows that that has in fact been a strong driver of pipeline development. The ability to reach commercially negotiated outcomes and non-code outcomes has been of real benefit to markets. The final point is about elasticity of demand for final products. Yes, you do make the caveat that the extent to which these factors constrain market powers differ across pipelines. We're not going to disagree with that in principle. However, we simply make the point that you need to take into account those alternatives that are available and the other points made in that major conclusion in assessing that particular point as well.

Against this background the industry has established a strong history of commercially negotiated outcomes. The evidence of monopoly misuse, as opposed to the mere possession of monopoly power, is based on narrow building block outcomes, a process which, as the report acknowledges, is subject to regulatory error, and that, we believe, has been evidenced in recent tribunal decisions that highlight the nature of regulatory error that has taken place to date in the interpretation of the

regime, where rectification has only been possible through that tribunal appeal process; but also the monopoly misuse argument is directly contradicted by the strong evidence of commercially negotiated new development activity in this industry. That is a point we've made previously so I'm not going to dwell on it.

The submission itself focuses on our view of recent Australian Competition Tribunal decisions, simply making the point that whilst there is an ability to address certain elements of inappropriate regulatory decision-making through that tribunal process - it's time-consuming, it's costly and we would certainly not view that as a panacea - it's more important to get the framework right in the first place. We provide commentary on the objectives and objects clause of the regime as proposed by the Productivity Commission. We strongly support an overarching objective that reflects the views expressed in that draft report, but we also think that the meaning of that provision needs to be clarified through either changes to the proposed definition or through explanatory materials, and that's an area we might touch on a little later.

We have concerns with the proposed amendments to clause 2.24 and it won't surprise you to hear that we're concerned that legitimate business interests might be somehow removed as part of that process.

MR HINTON: No, reference to it removed.

MR BEASLEY: Yes.

MR HINTON: Explicit reference.

MR BEASLEY: Yes, explicit reference to it, thank you. For point of clarification in the transcript, I may mention tier 1, which I take as a monitoring regime; tier 2 I take as a cost-of-service regime. Pipeliners always do things differently and that's something we have to live with; but the monitoring coverage test - we believe the fact that a less intrusive form of regulation is being contemplated in no way reduces the importance of ensuring that coverage is rejected where it does not advance economic efficiency significantly. We strongly endorse the Commission's draft recommendation that the coverage criteria include a new limb; namely the coverage of the pipeline is likely to improve economic efficiency significantly. While we support the Commission's proposed lifting of the threshold from a promotion of competition test, we remain concerned that this attempt to strengthen this test is substantially undermined by the retention of the likely threshold in the actual wording of that recommendation.

Our submission makes a number of other recommendations relating to the coverage test. We certainly recommend that the existing covered status of existing transmission pipelines be revoked. We accept tier 1 regulation being applied as a

default for those pipelines that are currently covered under the Gas Access Code, subject to the right of each pipeline to challenge that coverage status. We submit that existing pipelines should be covered under the monitoring regulation, unless the criterion is met for more heavy-handed forms of regulation to be applied.

We discuss an outline - our view of the monitoring arrangements that should be applied and we are concerned, as I believe the Commission is, that the potential for an initially light-handed monitoring regime could turn into an intrusive information intensive arrangement, not dissimilar to those prevailing in respect of access arrangement information under the current code. We consider that while the Commission's recommendations go some way towards minimising the risk associated with introducing a new level of regulation, there remain a number of critical issues to be resolved. We firmly believe that the Gas Access Regime itself - and through the work of the Productivity Commission - must prescribe the reporting framework for gas transmission pipelines and that the Commission's final report should provide definitive guidance on this particular matter. Our submission outlines its recommended approach in that respect.

Cost of service coverage test - tier 2 as we call it. We are concerned that the creation of that two-tier test will encourage access seekers and potentially regulators to ensure that the second tier of a regulatory framework is invoked. We believe that would create a perverse effect on access seekers; instead of seeking to enter into normal commercial negotiation, their incentive would be to ensure that they are able to secure a course to a regulator; a process that will significantly undermine their commitment to the very negotiation process.

Our concern that this light-handed regulation could become more heavy-handed over time is illustrated by the recent decision of the Australian Competition Tribunal on the Moomba-Adelaide pipeline system. Here the tribunal's decision highlighted the regulator's propensity to assume market power in respect of the incremental capacity expansion of the Moomba-Adelaide pipeline. We have serious reservations with the nature of the test between monitoring - in moving from monitoring to cost-of-service, and others have commented on this. There is no real distinction between the first and second tier threshold tests and we believe that that test is set too low.

Our submission discusses the lack of practical difference between substantial and material, and that's something we might get into during discussion. Certainly we have legal advice to suggest that there is no meaningful distinction between these tests, either as a matter of law or more practically, in actual implementation. Additionally, the absence of that difference is enhanced by the practical reality that both tests are applied in an essentially abstract environment which is prefaced by the word "likely". We would be happy to cover that.

We believe there should be a correspondence of an indifference in the test and the consequences in meeting those thresholds. The seriousness of the consequences of applying cost-of-service regulation is confirmed by the Commission's own assessment. In our view the challenge is to establish a threshold test for tier 2 that is consistent with the consequences it attracts and we recommend an alternative cost-of-service test whereby cost-of-service regulation could only apply to a pipeline where the decision-maker is affirmatively satisfied that (1) access to a pipeline has been unreasonably denied and (2) the absence of cost-of-service coverage, tier 2, has prevented competition from developing in a dependent market.

We also assert that in implementing this test the decision-maker cannot conclude that access has been unreasonably denied unless the terms and conditions on which it has been provided are inconsistent with the code. In summary then, we believe the cost-of-service regulation should only be applied when it is absolutely necessary to do so - that is, in extreme circumstances where there is a demonstrated misuse of market power, as opposed to the mere possession of market power.

Cost-of-service regulatory arrangements: we stand by our earlier model, whereby a negotiated arbitrated outcome is preferable, even with tier cost-of-service regulation. We believe the negotiated outcome model is more consistent with the nature of the transmission section in the way it's applied, and we have noted from other submissions that there are perceived to be numerous defects in the design and operation of the current regime, and that's an issue that's detailed in other submissions to the inquiry.

Our submission covers only one point in that respect: the initial intent of the code access arrangements was for a service provider to propose an access arrangement and the regulator to assess it, not apply a lease cost value to it. So we believed, to the extent cost-of-service applies, where a service provider goes forward with a reasonable range, then that should be accepted - with a proposal that is within a reasonable range, then that should be accepted by the regulator and there should be no ability to substitute their own values. Some of the consequences of the current approach is coming out in appeals, and that should be coupled with the full availability of complete merit review in the process. We note that the ACCC supports a full merit review, albeit for somewhat different reasons, but I suppose we've found an area of coincidence with the ACCC -which is good.

Issues for new development: we have reservations about the approach adopted by the Commission and note that new investment proposals are contestable in nature. You make that point as well. But we believe the key issue when considering regulation of new investment is whether that is in the form of a greenfields pipeline or an expansion or extension of existing pipelines, is how the regulator environment

will distort that investment. We're concerned that the Commission's recommendations diminish the role for access holidays, as suggested in the Parer report. Whilst access holidays will not correct the deficiencies in the current regime, they form an important component of a policy framework that has the objective of encouraging investment in pipeline infrastructure.

We believe that an almost inevitable result of the approach the Commissioners recommended is that new pipelines will become subject to monitoring for a five-year period, followed by the prospect of heavy-handed regulation being applied after this time. We do not think that was the intent of Parer. In contrast to the Commission's phraseology, we believe that a cautious approach will be one in which the caution is manifested in a reluctance to regulate in the first place. We submit, along with a number of other groups, that a 20-year holiday period is superior to 15 years, and we make no new points in our submission, simply reiterate the points we've made.

We agree that application of a fixed truncation premium potentially provides a vehicle that could ameliorate regulatory risk. However, we don't have any confidence that the current regulatory system would be able to deliver a sufficient premium absent any legislated or mandated provision quantifying its extent. We agree with the Commission's recommendation that competitive tendering provisions in the code should be simplified. We are concerned that the Commission's recommendation that has effectively recommended a reversal of the onus on pipeline coverage in respect of expansions - such a reversal would create serious distortions to the incentives for pipeline expansion. We submit that the approach will create a bias in favour of new pipelines instead of expansions to existing pipelines, on account of the former being exposed to regulatory risk.

I think an additional point is the tribunal decision in the Moomba-Adelaide case that also came to a set of conclusions regarding market power of expansions, which we'd certainly urge you to look at, if you haven't already done so. So quite - in summary on that issue of expansions, we believe that the appropriate approach to expansions and extensions to existing transmission pipelines is to apply the coverage test to such expansions or extensions before any form or regulatory oversight is applied. Our submission makes a number of other points regarding governance, which we're happy to touch on, but that's the main summary of my presentation, and I hand it to my colleagues to see if they have any additional points they wish to make that I may have missed in our submission itself.

MR CRIBB: I think you've covered it okay.

MR BEASLEY: I've probably taken too long and I do apologise for that.

MR HINTON: No, that's fine; we're in good shape for time. So Anthony and Euan

are fine at this stage, righto. Thank you very much for those comments and thank you also for APIA's submissions over the period. It's much appreciated by the Commission to have input from APIA into this inquiry and it's important we do have that input. Your introductory remarks focused on a couple of matters that I'd like to pick up on directly and then I've got some questions, and I know Michael has as well, that emerged from your written submission, as such. But let me start off with a question that I've put to a number, particularly those that are representing tranches of the industry, and that's this issue in our terms of reference about distribution versus transmission.

We have concluded that there are two sectors, there are differences, but that the differences are not sufficient to warrant two separate Gas Access Regimes, one for distribution and one for transmission, in circumstances where sufficient flexibility in the single regime can successfully manage the differences associated with transmission and distribution. You have a particular perspective on this issue, I'm sure, and we'd welcome your comments on that particular finding.

MR BEASLEY: Yes, thank you very much. I think prima facie the consequence by our assessment of inappropriate market behaviour should be the same whether it be transmission or distribution, so that extent I would simply say that that in itself drives you to a single regime, but with a capacity depending on the nature of the investment, and I don't even draw necessarily a distinction between transmission and distribution. I'll come to that in a second. The same basic framework would apply. I mean, we've read your recommendations and we're not arguing for a totally separate regime, as long as there is sufficient flexibility to address the legitimate concerns of we believe we've raised on the nature of regulation and the way it's applied to transmission to date, we feel that that is quite capable of being accommodated within a single regime.

I'd make the point that, you know, on the issue of greenfield investment for example, there are - this was discussed this morning - distribution sectors where they are genuine greenfields. Tasmania is a classic case. Similarly for transmission, I'd argue the majority of transmission pipelines are in fact greenfields developments and should be treated as such in that context.

MR HINTON: There is another reason for asking: some have put to us from both the distribution system, but also separately from transmission industry participants, that the start-off point with regard to revised system, a revised Gas Access Regime - that their particular sector, either transmission or distribution, should be put into the - if covered now, into the lighter-handed monitoring tier. We had that from transmission people for transmission and lo and behold the distribution people came along and put their hand up and said, "No, we're different to transmission; we should actually be in that starting point in the monitoring tier."

Our approach of the draft report takes the line that it should be a case-by-case judgment with the coverage issue and coverage criteria being directly addressed by the coverage entity - that is, in this case, the NCC, and that where you end up, either covered or uncovered or, if covered, whether in your monitoring or building-block approach to cost based price regulation would flow from that process on a case-by-case basis. If I heard you correctly, you have a particular view on that as well.

MR BEASLEY: Certainly from a transmission perspective, our submission indicates we should be in that monitoring tier, and we simply make the point, because of the nature of the customers we deal with, we believe that's a strong factor taking in that direction, and the fact that in practical terms there is a baseline that has been established through the so-called cost-of-service model for transmission pipelines that can be used as - at least a reference point in terms of monitoring regime and the fact that, if evidence emerged of gouging, inappropriate pricing behaviour, the opportunity is always open to take those assets to the cost-of-service tier - what we call tier 2.

MR HINTON: After the regime.

MR BEASLEY: After five years. Our submission actually doesn't presume that. Our submission presumes that, for whatever reasons, evidence might emerge conceivably - I think the market would work against this, but it is possible, although we believe improbable, that that evidence might emerge within five years, in which case APIA believes there should be every capacity to take companies to tier 2 within that framework, should inappropriate behaviour emerge.

MR HINTON: That's a key point. Is there anything anyone else would want to add on that?

MR CRIBB: The first point I think we wanted to make was the pipelines that are now covered never underwent a rigorous assessment as to their applicability of the coverage criteria back in the mid-1990s before the code came into force, so there's never been a rigorous assessment. So the starting point, we'd have to say, is that there needs to be that assessment of existing covered pipelines, be they transmission or distribution, for satisfaction of the coverage test.

The second point I think that we make, or that we need to make clear, is that with the voluntary access regime, or the code of conduct that we have put forward as our basis for operating our businesses, that in itself assumes no level of regulatory oversight, and that in itself assumes that parties will be guaranteed a right of access through that process, unless there is some demonstrated failure to provide access.

From our perspective, there is a key need to start on no presumption of coverage for the existing covered pipelines as part of this assessment process that has to be undertaken, if the code were to be changed on that basis.

MR MORTON: If I could just add - - -

MR HINTON: Certainly.

MR MORTON: One of the very important aspects of the draft report was the refocusing on coverage of economic efficiency. If you examine economic efficiency in relation to transmission and distribution markets, you might find materially different consequences in terms of the balance between price monitoring light-handed and more heavy-handed approaches, particularly given when you look at the nature of the markets. The transmission market is a highly-concentrated market on the buyer side, whereas that's not the case in distribution, for example. If you simply look at the application of the tests that have been suggested in the context of coverage, that could lead you to quite different consequences in terms of presumptions that may be made in relation to what transitional coverage arrangements ought to apply.

MR HINTON: There are two possible streams here: one is as in the draft report - that what we have today - and we're talking transition here - continues for that particular infrastructure until a judgment is made to do something different, against the criteria that are inherent in the revised system. That's the sort of construct in the draft report. We've now come along and seen proposals in reaction to that, "No, no, that's too slow, case-by-case; administratively expensive. Let's make a judgment that all covered pipelines should be put in monitoring because they've been through this process of building block assessment for some time now, and sometimes two or three times." But if I heard you correctly, that latter proposal would therefore remove the appropriateness of having a five-year binding ruling on coverage for monitoring. I can see some force to that point. If you automatically by category put all covered pipelines into the monitoring bucket, you would want to get them out real quick if experience showed that that was not on.

MR MORTON: Moreover, the industry would not want a rogue pipeline to destroy what is a lighter-handed approach that is conducive to a lot of very desirable outcomes, and so that's a very important point.

MR HINTON: This afternoon this is the first it's been put to us that that would be the preferred industry position with regard to monitoring. The proposal that's been put to us to date by both distribution and transmission is that the starting point should be monitoring if you're covered, but the five-year binding ruling should also apply.

MR BEASLEY: I would simply refer you to - I think it's page 28 of our final submission which says:

> APIA therefore submits that existing pipelines should be covered under tier 1 monitoring regulation unless the criterion is met for more heavy-handed forms of regulation to be applied.

We don't apply a time frame to that.

MR HINTON: That's assuming up-front that they should be, unless they're judged to be otherwise. You could be judged to be otherwise because you have not performed appropriately or someone has sought to have you assessed against the new criteria that would put you back into the building block approach. That's a variation again.

MR MORTON: With the caveats that you mentioned in your report relating to standing, that there needs to be a denial of access - - -

MR CRIBB: Bona fide.

MR BEASLEY: Bona fide.

MR MORTON: That there needed to be a denial of access before the issue of the more heavy-handed approach would even be contemplated.

DR FOLIE: So this really comes back to the point about the test which you mentioned, which is really the - forget about sustainable and competition, et cetera. Effectively, really, you wanted to have a very simple objective test, one of which was really the absence of - in other words, a denial of service; in other words, if you've actually been seen to deny service somewhere, that then triggers the fact that you're actually being - - -

MR BEASLEY: Which is measurable.

DR FOLIE: Which is a sort of measurable measure, yes. So it's intertwined; the no time frame is also intertwined with the change in how one would measure - in other words - a substantial impact on competition. You're more or less using that as the surrogate for the measure.

MR BEASLEY: Correct. That's right.

DR FOLIE: That's your definition of the measure.

MR CRIBB: Our rationale for that approach was - the original intent of these regimes -to provide a guaranteed right of access in circumstances where access was denied, and that access would be provided on fair and reasonable terms. That's the thinking of the Hilmer principles, et cetera. From our perspective, if we are offering access on fair and reasonable terms, there is no need to put in place a regime. If you have a demonstrated means of conducting your business on fair and reasonable terms, such as our voluntary code of conduct, then the role of regulation in those businesses has no role to play.

MR HINTON: It's a flow-on effect of what we're proposing to another form of access regulation - that's through Part IIIA. The draft report's shape of a Gas Access Regime with a monitoring and cost based price regulation tiers is essentially designed to ensure that Part IIIA default option of negotiate-arbitrate access arrangement or regulation structure would only operate for uncovered pipelines that fall neither in tier 1 nor tier 2. Now, to do that requires some adjustment, as you would have seen from the NCC's submission to us. Would you as APIA be comfortable with that formulation, such that even an infrastructure being monitored would not have a default option? A right to use or a user could not use Part IIIA to test the behaviour of the service provider that's been subject to a monitoring regime. Are you comfortable with that clear implication of our structure?

MR CRIBB: In essence, you're suggesting that Part IIIA has no role to play for gas pipelines. The only means of securing a right of access is through the regulatory framework set up under the Gas Access Regime.

MR HINTON: In circumstances where the threshold for the monitoring regime is about the same as the threshold for Part IIIA. In circumstances where there's a difference, then there could be a tranche of infrastructure that would be open to Part IIIA being uncovered by the Gas Access Regime.

MR MORTON: So, for example, if it was economically efficient to apply monitoring - or whether or not it was - the absence of, say, an economic efficiency criterion to Part IIIA could open the door to a negotiate-arbitrate regime that is in fact a substantially lower threshold than applies in relation to either price monitoring, the lighter-handed form or the heavier-handed form. Is that the point you're driving at?

MR HINTON: There are two intersections here: the highest threshold of the existing and also under the revised structure, building block cost based price regulation is quite high, and certainly higher than Part IIIA, as proposed in the draft report, right. At the moment they're about the same. As soon as you raise that, therefore, there's a question of whether the NCC would certify the Gas Access Regime under the Competition Principles Agreement is approved, it is certifiable; and if it is certifiable, then Part IIIA doesn't become operational. But NCC might not

certify it in circumstances where there's this middle tranche - that is, those that would meet the Part IIIA threshold but do not meet under the revised report the threshold for cost based price regulation.

We are seeking to bring that intersection back together, such that if you are subject to the Gas Access Regime tier 1 and tier 2, then Part IIIA would not apply. We need to construct that in the final report. But the second intersection is, as long as the threshold for monitoring is about the same as the threshold for Part IIIA, otherwise there is another wrinkle there somewhere to a smaller degree, a smaller level issue, where you mightn't get quite intersection.

MR CRIBB: This is an issue that Epic Energy dealt with at length at the time it was proposing its Darwin to Moomba pipeline, where it actually tried to put forward a voluntary access undertaking, or explored a voluntary access undertaking under Part IIIA in order to give it certainty as to how it was - I guess in order to remove the regulatory risk component of not having anything and then being exposed to a coverage application down the path.

The approach that it was taking was that if it could adopt a set of enforceable undertakings as to how it will provide access through a Part IIIA access undertaking approach, then that would remove that risk of coverage under the code in the future. The dilemma that was confronted by Epic Energy was that the stated approach of the regulator under Part IIIA access undertakings is that an access undertaking is to be assessed in accordance with the principles of an industry-specific regime, if one industry-specific regime existed. So you were caught in a bind of cost based pricing, a building block approach to regulation, for an access undertaking in circumstances where that was the very thing you were trying to avoid.

MR HINTON: But only if the NCC had certified that the Gas Access Regime that would apply through that state jurisdiction was in accord with the Competition Principles Agreement. That's important: that if it didn't, then it wouldn't be certified; therefore, the default option of Part IIIA would be activated. The concern at the moment is that the monitoring option does not provide two key things: it doesn't provide guaranteed access. It says you've got to have an access policy but it doesn't provide dispute resolution mechanisms if someone says, "I didn't get access the way I wanted access." In the absence of that, prima facie, the NCC is unlikely to say that that structure, as in the draft report, would be certifiable. That would leave open the option for something being monitored to be then subsequently subject to Part IIIA at the same time, which would seem to be excessive overlap with regard to regulatory intervention.

MR CRIBB: The position, I guess, we take from that is that even with a two-tiered structure that is proposed in the draft report, there is a guaranteed right of access.

There is a guaranteed right to apply for a coverage for a tier 2 application. We have to remember that the coverage test would meet the effectiveness test in itself, in that you do have a guaranteed right of access for infrastructure which satisfies the very type of infrastructure that was intended to be regulated under the competition principles of that.

MR HINTON: But Epic and APIA would have to be satisfied on this point. NCC has to be satisfied, and that is what we will be developing between draft and final report. I did want to get a solution to this problem because it's on our table and we're looking at it. It was really testing the concept that we would need to check with interested parties their views on this issue of if monitoring is operative, Part IIIA is not, in circumstances where monitoring falls well short of - - -

MR BEASLEY: I simply make the point that the monitoring is simply part of a continuum and that there are in fact mechanisms. We may discuss the nature of that mechanism for taking you to - - -

MR HINTON: If you look at the regime as revised as a whole, then you could say that that regime as a whole should be certifiable.

MR BEASLEY: Yes.

MR HINTON: Certifiable? Certified. I must get my terminology right.

MR BEASLEY: We certainly wouldn't want to see cherry-picking.

MR CRIBB: If I could just explore that a little bit further.

MR HINTON: Certainly.

MR CRIBB: A regime is effective under Part IIIA test for effectiveness if it guarantees a right of access. That has got to be one of the key foundations of an effective regime because that's one of the tests under the CPA. The proposed regime in the draft report still maintains a guaranteed right of access for infrastructure that satisfies the tier 2 test. Infrastructure that does not satisfy the tier 2 test has a monitoring component of it. The fact that monitoring regime does not in itself, at this point in time, stipulate that it guarantees a right of access should not render the regime ineffective.

MR HINTON: We could argue that. You could argue that. We would want to be comfortable that it would be persuasive in the documentation to convince the NCC that the outcome would be that. That's the point.

MR CRIBB: I think we start then from a premise - and this is the unfortunate circumstances that have unfolded in the last five years - that every piece of infrastructure should be covered, should be regulated on a building block cost-of-service approach, which we argue - and I think we've been very strong in our submissions to date - that that should not be the starting presumption. I think the Productivity Commission starts from that perspective as well. So for so long as you are concerned about not guaranteeing a right of access for every piece of infrastructure that might in some way be regulated, I think we're starting from that wrong presumption which was never intended as part of the competition principles.

MR HINTON: But it was. That's the point. If it meets a certain infrastructure test, then access is what it's all about.

MR CRIBB: But that's my point, that you do still guarantee in this two-tiered regime a guaranteed right of access for those pieces of infrastructure which meet the tier 2 test; so you do have that guaranteed right of access. You just bring into the fold another form of regulation or monitoring for pipelines which don't necessarily meet the tier 2 test, but that shouldn't render the regime ineffective, because you still secure a guaranteed right of access for pieces of infrastructure which should be regulated and should be assured a guaranteed right of access.

MR HINTON: But this goes directly - which is how we got into this discussion - to your point about questioning the five-year binding ruling that we have inherent in our proposal for the monitoring tier, that it would be case-by-case assessment, judgment made that you qualify for monitoring, not cost based price regulation, and it will hold for five years to give the parties scope to go away and negotiate and get on with it. That therefore means that access is being negotiated but not guaranteed. Part IIIA consistency - in shorthand - might be more persuasive for the access regime as a whole if we operated your proposal; that is, you could move within five years back to the cost based price; but your starting point is that they're all in there to start with, as opposed to case-by-case assessment. If you have case-by-case assessment it could not substantiate the scope to move back within one day to cost based price regulation, if you've made a judgment on that case. I assume that would be your very strongly held view - you'd want the five years to apply.

MR BEASLEY: If you had to go through the process.

MR HINTON: That's why this afternoon is a slight wrinkle on what we've been hearing so far, which is why I've taken some pain to explore the options of five years and the operations of Part IIIA.

MR MORTON: Perhaps it's also worth recognising that ultimately the reforms to the Gas Access Regime themselves will become a creature of COAG, just as the

Competition Principles Agreement was, and that at that level there should be substantial capacity to iron out those wrinkles. When we think about the way in which your recommendations will ultimately be implemented - - -

MR HINTON: No, you're spot on; that is, to deliver this outcome as intended, the way to do it is to change clause 6 of the competition principles - you're right - which is COAG; but the first issue is there is an issue, then looking at the possible solutions, and we're looking at several possible solutions.

MR MORTON: Could I take that a step further, though, because it is relevant that all of your recommendations have the benefit of the experience that the Competition Principles Agreement hasn't had in the sense that it would strike even before Part IIIA or at least contemporaneously with Part IIIA. It is really a very old document now, without the benefit of the experience that we've had. In fact, you look at the recommendations you make in terms of, for example, economic efficiency in the coverage test. It's a very important point. It's an extremely important point. That's really what this whole process is all about, and yet it was omitted from the Competition Principles Agreement. I would suggest that that is actually what is appropriate, that the Competition Principles Agreement really requires updating to take account of some of the lessons we've learnt over the last - it's really a decade now. The Competition Principles Agreement was 95.

MR HINTON: Though I should add a note of caution that COAG processes are very complex, very difficult to deliver consensus that is implemented in concrete form with uniformity. That is, you only raise proposals to change COAG agreed principles or statements or objectives if you're very sure of your ground; only in circumstances being very sure of your ground that is persuasive.

That's a useful discussion on that topic. I'll move on now to another matter that I think Alan picked up in his discussion but also it's early on in your letter. That is this reference to recent decisions. Clearly, things don't stand still when you do an inquiry. Events occur, whether it be court cases or ACT determinations or judgments by the regulators.

You rightly flag that it's important that the Commission take account of these events in moving from a draft report to a final report, but I want to hear your comments on how this can best be done, how the system can take account of judicial and quasi-judicial outcomes. Some could lead to changes to the Gas Access Regime, the code. Others could be done on a simple lesson learnt by the regulator and he's not going to get his fingers burnt again and he will therefore make judgments consistent with those determinations. Do you have a view on those two of several possible options about how those decisions, those events, should be inherently added somehow to the Gas Access Regime?

MR BEASLEY: Would anyone else like to start on this?

MR MORTON: First of all, it's the point that Allen made in his opening address, which was very much the role of the regulator is not to set a position, but to establish a position and that if a position is put forward that is reasonable, then that position ought to be endorsed and not be subject to another person's different view of what the position might be, or the regulator's position - so one of the very important issues to emerge from the tribunal decision in GasNet was that if a reasonable position was put forward by the regulator business, by the pipeline owner, then the regulator should be duty-bound to endorse it, rather than to substitute its view, which may be a different view.

But so often we find in these processes that - and one of the frustrations of these processes is that there is no absolute right answer; it's a question of one person's view against another, and to discipline the pipeline owner in putting forward a reasonable position, such an amendment as was suggested in the tribunal's decision would not only discipline and address regulatory risk to a large extent, but it would also ensure that infrastructure owners had stronger incentives to put forward entirely reasonable positions in the first place because then they had a high probability of being endorsed.

I think also the second issue that needs to be borne in mind in that context is the economic efficiency of coverage, because we simply have to accept, I would suggest, that at least as it's manifested to date, and that perhaps history is the best indicator of the future, that heavy-handed regulation will continue to be heavy-handed regulation and that there is a very high propensity for regulatory error to occur as part of those processes. That needs to be explicitly considered when we consider the economic efficiency of coverage applications and that perhaps in the context of the Commission's recommendations to clarify the promotion of competition, perhaps even we could go further and suggest that in the context of economic efficiency that regulator error be explicitly incorporated or considered in that context.

MR HINTON: What if the ACCC said, "No, of course we take account of those decisions and so, in future, our behaviour will be modified by those events"? Isn't that sufficient?

MR CRIBB: One of the things, I think, that has come out of the Commission's deliberations is the wide degree of discretion of a regulator which is not supported by clear objectives. I think that might be paraphrasing your thoughts, but from our perspective it's that wide degree of discretion without clear direction on objectives which has given rise to an ability for a regulator to think that they can basically substitute a service provider's proposal, which for the most part is a reasonable

proposal with another version which, in the regulator's eyes, is actually perhaps a more reasonable outcome, because the regulator takes the view that the regulator has the ultimate discretion to make the final assessment.

But I think what we come back to, once again, is that this is an assessment process, assessing what the service provider has put forward for tier 2 - you know, for access arrangement approval processes. It's not one of - it's not a determinative approach; it's an assessment of what the service provider has put forward and whether that is reasonable. There is a clear excerpt from the Competition Tribunal's decision in the GasNet case - there's a very good quote that I think we've put in our APIA submission.

So from our perspective I think the changes that could be recommended to take into account these recent decisions is very much to say, "Make it clear that having regard to the objectives of the gas regime, is it the role of the regulator to assess whether the service provider's access arrangement is a reasonable access arrangement, having regard to those objectives?" Whether it fits within a reasonable range.

MR MORTON: Could I respond to your final question?

MR HINTON: It wasn't my final one.

MR MORTON: No, it wasn't our final - your last question, I'm sorry. I'm sure it's not your final one. I guess when we look at the history of regulatory decision-making, the code came with the promise of light-handed regulation and its implementation - I'd suggest, and does the Commission find that it's been anything but light-handed regulation. The point I'm simply making is that in making a decision to cover a pipeline and all of the consequences it brings, one of the adverse economic consequences is the very heightened risk of regulatory error that comes with it, and that that should be explicitly considered in the context of the decision with all of its implications, some of which we have seen, as you have referred to in your draft report in terms of the distortions to investment and that, from an economic efficiency perspective, they are very dramatic because they apply across the whole range of output as opposed to the other kind of efficiency consequences that occur at the margin.

I would simply finally make the point in terms of institutional reforms, it does underscore the very important role of merits review in decision-making processes, and simply endorse your recommendations on merits review with the exception that the very strong view that constraints on merits appeal to the documents that were before the decision-maker shouldn't apply and that there is in fact no valid reason for such a constraint to apply.

We outlined the reasons in the APIA submission, but I would simply like to draw your attention to one particular factor, which is that the current situation does create the prospect of a regulator having a last say without the opportunity for recourse with new material occurring or emerging out of a final decision, and that that in fact is a very important aspect of the process to discipline through the institutional arrangements; ie, merits review not being constrained in the way that it currently is.

MR CRIBB: That's a position that's borne out of experience from previous regulatory processes. Substantive reports prepared by regulators were released after the event or at the same time as the end of the regulatory process without giving service providers or any stakeholder an opportunity to respond.

MR HINTON: You have explicitly referred to a number of occasions the overarching objective is put forward in the draft report, with particular emphasis on efficiency, and you have certainly endorsed the intent behind that recommendation 5.1, but in your submission you raise the idea that the objective of efficient use of pipelines should be subordinate to that of efficient investment, and that implies to me that you see a potential conflict between efficient use and efficient investment. Can you give me some more concrete example of how that might arise? I am a bit puzzled by it.

MR MORTON: I don't think that there was a misunderstanding between our interpretation of what the Commission was suggesting. APIA's concern was more directly affected by the fact that when others come to apply these objects, issues can be read into them - or perspectives can be read into them - that weren't intended, and so, frankly, I did not necessarily see a conflict in those words, but I certainly saw the prospect of conflict in the interpretation and I thought that that interpretation aspect needed to be addressed and it comes back to the point that Allen made again in his opening remarks about the clarification that was required - just to repeat.

I didn't necessarily see alarm bells ringing in the way that I believe the Commission interprets them, which is exactly the same way as I interpret them as an economist. I think different economists might have different views and I thought that it was desirable that that be clarified so as to remove the possibility of a conflict between the two; one being that when there's spare capacity in a pipeline, for example, it being determined that the efficient use of the pipeline would be for someone to mandate that that spare capacity be sold at marginal cost; for example, that could be consistent with one person's view of the efficient use of a pipeline.

MR HINTON: It is.

MR MORTON: But it's certainly not consistent with necessarily encouraging efficient use in pipeline infrastructure, and so that was just one example of where there could be conflict in terms of the interpretation of the objects clause and, given its heightened importance, which we recognise and endorse - given that importance, we felt that it was important that the issue be clarified.

MR HINTON: In this context I flag the need for us to take account of another event that hasn't been referred to, and that's the government's response to the Commission's inquiry into Part IIIA - the final response - where the overarching objects clause was endorsed - that was a recommendation of the Commission's report, endorsed by the final response by government, but it uses slightly different words to that which we have in our draft report, and they add in the term "and operations of", not just "use of" and, before "competition" they add the words "defective competition". There would be some prima facie benefits in our final report being consistent with that final response of the government to the Commission's inquiry into Part IIIA. I alert you to that issue, as well, given that you have a particular focus on the overarching objects clause in our draft report.

MR MORTON: Just in response to that - and the insertion of the word "efficient" before "competition".

MR HINTON: "Effective".

MR MORTON: "Effective", I'm sorry. Our suggestions, which I believe are consistent with your objectives or your views in terms of putting forward that test, is that what we don't want is the promotion of competition to become an end in itself but rather a means to an end, and that perhaps that concept is more effectively captured by instead of referring to "effective competition" referring to "competition being promoted where it is economically efficient", which is consistent with APIA's suggestion.

MR HINTON: Say again - promoting competition that's economically efficient?

MR MORTON: Where it's consistent with economic efficiency. You don't want to necessarily promote competition for the sake of promoting competition.

MR HINTON: No.

MR MORTON: You can imagine that competition - - -

MR HINTON: Competition is the mechanism and the objective is efficiency.

MR MORTON: Exactly, and that concept is not actually reflected in the objects in

terms of promoting competition.

MR HINTON: "Thereby promoting" - upstream and downstream markets.

DR FOLIE: The more words the more complex it gets, but one needs to have, as you have alluded to, the understanding of what lies behind it, but the more you build words in the more there is room for legal dispute. More words don't give - - -

MR BEASLEY: All the more reason to be very clear - if there is a form of words, to be very clear on the intent - and that in itself gives direction.

MR HINTON: Yes.

MR MORTON: Could I just direct your attention to the last paragraph above 3.2, where we simply suggest - - -

DR FOLIE: Which document?

MR MORTON: I'm sorry. APIA's submission, where we simply suggest that - clarifying that the object is to promote competition in upstream and downstream markets, where it is consistent with economic efficiency. That's all we're suggesting there at page 15 or 16, the second-last paragraph of text - 3.1.3, last paragraph.

MR HINTON: We're probably not in heated agreement, but we're certainly not in fundamental disagreement. Let me dare raise the issue of us seeking to try and bring clarity to the objectives by not only giving an overarching objectives clause but seeking to remove other statements scattered throughout the documentation that touch on a whole range of objectives or implied objectives or secondary objectives, such that there are certainly perceptions of conflict that lead to uncertainty in regulators' minds and courts' minds and whatever; hence 2.24 issue.

You have objected to our suggestion, not the deletion of - that there exists the legitimate business interest, but the actual explicit reference we're seeking deletion from 2.24, along with some other factors, such as interest of users and potential users. Once again that I put to someone else this morning: doesn't the pricing principles reference to expected revenue at least sufficient to meet efficient long-run costs encapsulate legitimate business interests? And of course being in the pricing principles it's in that order, not in the objectives area of 2.24. I am trying to give you comfort.

MR CRIBB: I think what we were trying to do was to learn from the recent judicial and quasi judicial decisions that pipeliners, transmission pipeliners, specifically have been involved in, where the comment particularly in the Dampier-Bunbury Supreme

Court decision makes reference to the rationale behind the inclusion of the section 2.24 considerations, in that they embody a number of dimensions - the political dimension, the public interest dimension, the economic dimension.

There is specific reasoning of the court in that decision, which says that the intent of Hilmer was to encapsulate those dimensions and that it was to ensure this was not an economic prescriptive document, but that it was a document which had to be approved by parliament. So it was taking into account a number of other interests and so by removing those very considerations you are potentially giving rise to a narrower focus or a narrower dimension to this piece of legislation. The court was actually quite keen to ensure that those objectives, or those considerations, had their full force and effect and the fundamental role that they played in an assessment process.

They then pointed to how that was consistent with the effectiveness test under the Competition Principles Agreement and to take those away from an assessment process of an access arrangement, which of course, is a de facto arbitration process - if you remove those very considerations, which an arbitrator under the Competition Principles Agreement is required to have specific reference to, there is a question therefore of the potential for a regulator who is a de facto arbitrator to take into account a set of considerations which are different to or not explicitly the same as the considerations which an arbitrator must take into account under the code. So from our perspective there was a need to ensure that there could never be seen to be a different approach taken by a regulator to what an arbitrator might come away with, bearing in mind that the arbitrator is bound to accept the reference that a regulator sets if the dispute is about a reference tariff - a reference service. Our concern is to ensure there is consistency when the access arrangement approval process is very much a de facto arbitration process.

DR FOLIE: But aren't you then left with - if you have got A, B, C, D, F and G, sitting in that section that different weights could be set on them by different groups at different times because it's a suite of points that go within section 2.24?

MR CRIBB: Yes, and we say that that was a very deliberate reason for inclusion of those when you read the reasoning of the court in the Supreme Court decision: that they embody those other dimensions that this type of regime must take into account and must demonstrate through the outworkings of it. It has got to take into account those other dimensions.

DR FOLIE: Including any other matters the relevant regulator considers relevant?

MR CRIBB: I think we advocate in our submission that that should be removed.

DR FOLIE: Yes.

MR CRIBB: But clearly that other set of considerations are important too, when the very structure of an access arrangement process is that it is a de facto arbitration and the arbitration process requires consideration of those very objectives.

DR FOLIE: But then you're ticking the box on all the other ones - the interests of users, prospective users, the public interest - all of those you believe should be retained?

MR CRIBB: Yes.

MR BEASLEY: Our fall-back position is that they be retained, so that won't surprise you.

DR FOLIE: No.

MR MORTON: Can I just explain though in that context why we believe it's very important that if - leaving aside Anthony's very valid point why A is very important in the context of the objects, because what can easily be forgotten is that the very object of this regime is justified withdrawing of a proper right that forms a fundamental part of our economic system, and so recognising the legitimate interests of the person from whom you are removing that right seems appropriate in the context of the overarching objects of the regime. Moreover, in the context of the point you made, covering the long-run efficient costs, can I suggest two things: first of all that legitimate business interests is a wider concept. It's a much wider concept.

MR HINTON: I thought you would argue that one.

MR MORTON: But, secondly, and very importantly, every regulatory decision would, I'd suggest to you, indicate - or every regulator in making a regulatory decision today would strongly assert - as has been asserted in the tribunal, for example - that the long-run efficient costs had been covered; in fact we've seen in recent history two or three tribunal decisions that have cast very serious doubt on that, despite the very stringent limitations on matters that can be brought before the Commission or the tribunal.

MR HINTON: Let me be a little inflammatory then. You've mentioned on a number of occasions, and we're going to get on to this further, about the need to be precise, clear, as to intent, when we start to make changes or use specific words or obtain guidance in the Gas Access Regime, and that it's very helpful if we were going to pursue changes through this inquiry process that we be as clear as possible and spell it out as much as we can, so that we go all in the same direction, speaking

with the same voice.

If you start to have a listing of objectives with no guidance whatsoever as to how you would balance conflict, with no principles or criteria by which you're going to have the regulator, let alone the courts, make judgments as to how well prospective users' interests are going to be taken into account, but at the same time we're going to be looking after the legitimate business interests of service providers, to my mind that section 2.24, if I was going to be inflammatory, is a minefield of judicial uncertainty and regulatory uncertainty, and is exactly the sort of thing that we should be trying to redress.

MR CRIBB: Can I respond to that by coming back to 2.24. It has a number of limbs to it. The first limb is: a role of a regulator is assessing what is put forward, so that's your starting point. You assess what's put forward. You don't determine an outcome. You assess what's put forward by the service provider. If that is reasonable, having regard to the 2.24 considerations, which gives significant scope then for a reasonable outcome, that's what the role of the regulator should be. The role of the regulator should be, having regard to those considerations - creates a fairly wide ambit for what could be a reasonable outcome, and that's what the regulator has to make the assessment.

So I don't consider that it creates any uncertainty. What I say is, bearing in mind what an access arrangement and approval process is, a de facto arbitration, bearing in mind what the Competition Principles Agreement says an arbitrator must take into account, we are simply preserving the consistency with the role of an arbitrator in the role of a regulator.

MR HINTON: Yes, thanks, Anthony, but take it to the next step when it's appealed. A consumer says, "Well, you've certainly taken account of the legitimate business interests of the service provider but me, as a consumer, I challenge that decision. My interests have been usurped and derogated from in a manner that is directly in conflict with 2.24." The judicial process says, "Well, how do I resolve this? I don't have any guidance as to what weight I put on A or B or C or D," and the Epic case I thought was a fine illustration of that exact issue. He threw his hands up in the air and said, "I don't know how to balance those conflicting objectives."

DR FOLIE: But the regulator had to make a judgment.

MR HINTON: Yes, the regulator had to make a judgment.

DR FOLIE: Had to make a judgment, taking them all into account.

MR CRIBB: I don't see that those objectives, that those considerations - and we've

argued for their retention - how they're in any way inconsistent with the overarching objectives clause that is being proposed. So are we going to have any less uncertainty about interpretation of the objectives clause with those section 2.24 principles removed? Our position in the submission is simply that if an access arrangement is acting as a de facto arbitration and the result of that access arrangement approval process is one which is binding on the arbitrator, if the arbitrator has to consider those very considerations that are embodied in 2.24, we must ensure that the regulatory outworking of the access arrangement approval process takes into account those very factors that an arbitrator has to, otherwise the arbitrator is looking at something which he has to consider or he has to accept, but it mightn't have been determined on the same set of considerations that he himself has to apply as part of his jurisdiction when he's assessing an arbitration.

MR HINTON: Okay, that's useful for me. And, Anthony, your referring back to history is an interesting perspective and a useful one. We're running out of time fast and I've got to page 1 of 14, but that's not unusual. I might skip over a few possibilities. Let's explore again these thresholds. I think, Allen, you referred to them in your introductory remarks and also raised the possibility that we'd want to explore it, so let's explore it. You've got two aspects here: one is that you're not sure about clarity, as to the meaning of. I think we're on a par with regard to the intent, in terms of what level the thresholds are for material and substantial.

The issue then becomes one of - can we add flesh to the final report that better prescribes, describes the words underpinned by the intent to make sure that we get clarity into the operation of the thresholds, and I don't think anyone disputes that, and we're on board with that; we'll try and do that further. We'd like to think we could come up with explicit concrete examples that would illustrate where material is operative and substantial is operative, but we'll see how we go on that.

But the two issues you've come up with that perhaps I'd like to explore is, firstly, did you think that "material" is different to the current promote competition test? How different is it? I want to hear your views on that. And, secondly, you think that "substantial", even if it did mean big, and larger than "material" - you don't like it anyway and you want to have your own test for the activation of the cost based price regulation. Now, I've probably put words in your mouth to some extent, but they're the sort of - a rather too lengthy introduction. I seek your reaction.

MR MORTON: I think that there are two issues in the context of what the Commission is seeking to achieve, which we understand. I guess a problem is that we need to consider this in the context of the hypothetical in which the test is actually applied. APIA's legal advice is subject to very explicit legislative direction as to what is meant by substantial, that the two concepts are very similar, and that's simply the legal advice that APIA has received, and perhaps Anthony is better to talk

to that, but given the available precedents, they are very similar.

Can I also mention, though, in that context to you that we need to consider this in the hypothetical of the next 10 to 15 years, and trying to understand the difference between these quite similar concepts in an abstract 15-year investigation as to what are the competitive impacts of alternative regulatory structures or measures, which I think becomes very much the context in which we need to consider this issue of tier 1 versus tier 2, and which, at least to my mind, makes them virtually indistinguishable in terms of the application of the two tests.

And so it was thought perhaps desirable to recognise that fundamentally there is in APIA's view no case for heavy-handed cost-of-service regulation or, in our preferred model, negotiate-arbitrate, to apply an imposed outcome to occur, unless there has been clear evidence of a denial of access, which is a sensible test, we'd suggest, before attracting such a serious consequence. We've got two very similar tests of two very similar sets of thresholds with dramatically different consequences at present, and so APIA felt that it was important to distinguish the tests with respect to the consequences they attract, and that there is no case for a - sorry, Allen, I'll defer to you.

MR BEASLEY: No, sorry. And simply a test that relates to the behaviour that we're actually trying to prevent.

MR HINTON: All right. Well, let's explore that further. There are two parts here. One is material and substantial. I understand the legal history that "material" can be interpreted as "substantial", and a number of rulings have been to that effect: "material" means "substantial". But that has invariably been in circumstances when "material" has been seen in isolation; that is, the word "material" is being judged as to what it might mean or might not mean; non-trivial, substantial, something in between.

And I can understand how you can get legal debate and legal conclusion - although I'm not a lawyer, I hasten to add - that "material" could mean "substantial", but importantly, with regard to the draft report, we have the juxtaposition of "material" and "substantial" in a framework where it's put, that "material" is that, and "substantial" is something larger; therefore, to my mind, the concepts of one being smaller and the other being larger are quite clear and precise and does not lead to a conclusion - no matter what court, I would have thought - that they are the same. Juxtaposition is powerful. Seen in isolation, I can see debate, but we will seek to try and flesh that out.

MR MORTON: I was once a lawyer. I haven't been for over a decade, so I'd rather not answer that. I simply look at the practical application of the test being

very difficult to differentiate in practice, even if that's correct.

MR BEASLEY: We're in a position where we have to rely on lawyers.

MR HINTON: So do we.

MR BEASLEY: Yes, that's right.

DR FOLIE: But the point is, all of them, even the existing one, is - because the boundary is blurred. Any of these by their nature are slightly blurred. It's just we have a blur there and we have - - -

MR MORTON: Well, the blur is so dramatic because of the word "likely".

MR BEASLEY: Yes.

MR MORTON: The word "likely" means that the juxtaposition I suspect is irrelevant because the likely impacts, the possible - the mere possibility of impacts is likely to be similar. We're dealing with a pipeline.

MR BEASLEY: There's no probability based assessment. It's a judgment.

MR CRIBB: And that's what we say sort of brings down the hurdle significantly.

MR HINTON: It's the probability factor. That's a useful nuance that we're looking at as well with our legal advisers.

MR BEASLEY: And "substantial" and "material" and juxtaposition - I think we'd have to say that's an issue for legal advice. You know our intent, and I maintain that this regime should be characterised by onerous requirements that relate to behaviour that is not appropriate in the context of the regime, and I want to be a little careful, because I get back to your point about not trying to ping people because they're deemed to be misusing market power, but we think a test that's based on some objective basis of how you're behaving in the market - and I'm saying this from a transmission perspective - is very relevant.

MR HINTON: Well, let's take denial of access. I'm uncomfortable with a criterion that is built around judgments as to whether or not access has been denied. I'm trying to get a service from a service provider. They're not a monopoly, and I say, "Look, I'm willing to pay X cents," which is ridiculously low, and the service provider laughs me out of the room. I have been denied access. This is semi-flippant, I know. Reverse it. There's a monopoly pricer, and the user comes along and says, "I'm willing to pay X cents," which is a reasonable price, and the

monopoly guy or the service provider laughs him out of the room. Once again, service access has been denied in effect in one form or other. Now, both occasions end up in intervention occurring on that simplistic single-profile dimension judgment, so actually spell out, elaborate, what is meant by denial of access, then over to you.

MR CRIBB: Yes, the key point that we have to make clear is that there has to be no capacity to reach a commercially negotiated outcome. If there is a big stick threat there of a coverage application, we would take the view as an independent service provider that there would be very limited instances where you could have a denial of access. You would actually reach a commercially negotiated outcome. I think we might be starting from the premise that there is no scope for commercially negotiated outcomes and you may have to therefore put in place a regime - - -

MR HINTON: But isn't there game playing potential here, Anthony, that a bona fide request for access is hard to be tested?

MR MORTON: But isn't the fact that the second dot point of the coverage test being the absence of - to tier 2 coverage has prevented competition from developing as a dependent market - go some way to alleviate our concerns? Because it's not just being satisfied of a denial of access; it's also being satisfied that the absence of tier 2 cost-of-service regulation has prevented competition emerging in a dependent market - provide some clarification to your concern?

MR HINTON: It certainly has some force, yes.

MR BEASLEY: If this transmission industry post privatisation had a history of denial of access I would have thought that would have emerged, because a lot of these access arrangements actually haven't been finalised - you know, hadn't been finalised over the period, in which there have been quite a series of successful negotiated outcomes, including in respect of new contracts, new pipeline - all the development that is attributed to the code has in fact been developed as a result of that normal commercial negotiation process. I can only put forward the counter evidence in terms of the actual outcomes that have occurred at the transmission level. Our previous submission in December goes through all of those major developments in terms of the negotiated outcomes that have been achieved.

MR MORTON: And that's 98 per cent of new pipeline investment and the other 2 per cent emerge from - - -

MR BEASLEY: The other 30 million was a pipeline that was covered under the regime, the Central West pipeline.

MR MORTON: With government support, so it wasn't a true market outcome in that sense.

MR HINTON: Why are you concerned about us deleting health and safety? Once again, I should rephrase that - deleting the reference to health and safety.

MR BEASLEY: I trust that no-one would ever want to delete health and safety.

MR HINTON: Exactly.

MR MORTON: In answering the question, it perhaps hasn't figured terribly prominently in regulatory or coverage decisions to date and APIA would acknowledge that. Simply as a matter of principle, though, it suggested that if in fact health and safety issues are likely to emerge, they're likely to emerge on a generic basis and therefore the appropriate place to deal with them is in fact in a coverage application rather than downstream, as it were, or downstream process-wise in terms of a regulatory arrangement itself.

MR HINTON: Yes, it's the coverage criteria that we were baulking at.

MR MORTON: Yes. We were simply making the point that whilst we recognise that it hasn't provided substantial enlightenment on the merits or otherwise of coverage, to the extent that it's an issue, it will be a germane issue and therefore - - -

MR BEASLEY: I don't think we should presume that that won't be the case sometime into the future.

DR FOLIE: I find it difficult because there are very stringent state and federal regulations about how they need to be run. There's a technical regulation that runs through equally as much as the code doesn't have to say that everybody must be paid over-award wages or - you must comply with a whole lot of other things when you're running your business, and that seemed to us to be unnecessary in that sense, or clouding the issue.

MR CRIBB: The only comment, I guess, that we could add to it is the experience from overseas seems to be suggesting that regulatory arrangements have led to a - I guess, a loss of focus on health and safety issues. So if you remove that consideration from (a) having a system that has been maintained appropriately, then you have a risk that that is not going to be a prime consideration - it's never one that you can assess because the evidence will never be there on day one. It's a long-term issue.

MR HINTON: But it can be part of the access arrangements, as we proposed. It is

not ignored. It is just taken out of coverage. It doesn't seem to be germane as to whether or not there is market power here; it's to do with appropriate parameters for an access arrangement. Anyway, let's move on.

MR BEASLEY: Yes, in principle I don't actually disagree with that assessment.

MR HINTON: Expansions - we had a line that if a pipeline is covered, infrastructure is covered, then an expansion of that prima facie should also be covered. We don't quite use those words. I think you expressed some concern with this draft recommendation. We've run into terminology problems in some other hearings where there are distinctions, and appropriate distinctions between extensions and expansions and people sometimes inappropriately mix them up and whatever, but I'm a little puzzled why if there's a rigorous, robust reason for coverage for a pipeline, why any expansion of that shouldn't be covered and that the market power inherent in the existing pipeline would flow automatically through to the expanded pipeline. I'm not sure of why you're concerned.

MR CRIBB: I think we only have to look at the decision of the tribunal in the Moomba-Adelaide Pipeline decision, where it was made fairly clear an expansion will occur - in that circumstances the expansion occurred as a result of a commercially negotiated outcome. There should never be a compulsion on a service provider to fund an expansion. There's no recommendation from the Commission to change that aspect.

MR HINTON: Correct.

MR CRIBB: So you then look at if you've reached a commercially negotiated outcome, you have a desire then to fill any spare capacity in that pipeline on the terms on which you built it. So you have a driver then to want to fill any spare capacity that exists, as a service provider. The tribunal in that circumstance found that there was very little ability for the service - well, no evidence had been brought forward by the regulator in that instance of an ability for the service provider to exercise any form of market power over that particular expansion. So there shouldn't be a general presumption that that particular expansion - and we would argue in this stage of the development of the pipeline industry that any expansion should be covered.

MR HINTON: This is similar to the concept of foundation customers; foundation customers for the expansion in effect.

MR CRIBB: Correct.

MR MORTON: That's what happens.

MR CRIBB: That's the way it works.

MR HINTON: You don't think the existing service provider whacks on a compressor because he thinks he might be able to sell more gas?

MR MORTON: I think the history of the regime in the last five years has actually ensured that that will never happen.

MR CRIBB: You want the market before you - - -

MR HINTON: Because of the threatened regulatory risk.

MR CRIBB: Epic is a perfect example at the moment; it's not expanding anything because of the circumstances on the DBMPG - - -

MR MORTON: And not just compressors, looping - - -

MR CRIBB: Every form of expansion.

MR MORTON: Could we just refer you to the statements that were made in the earlier - last time we met - right to that effect; both Duke Energy International and the director of Epic Energy, making that very comment very clearly in absolutely unequivocal terms, because it is quite fundamentally important in terms of the way economic efficiency has been adversely affected by some of the regulatory intrusions we've experienced.

MR HINTON: Thanks for that. Michael, how are you going?

DR FOLIE: No, I think I'll be quiet now.

MR HINTON: The expansion covered one, I think we could talk about that for a bit longer but I think we've actually got your point of view. And that's important, to have it on the transcript, on record. That's what I was really pursuing rather quickly, given that it's now 5 past 3 and planes beckon. Have we left out something that's a burning issue that has to be solved, that we haven't covered yet? That's mixed up a few metaphors.

MR BEASLEY: From my perspective we've had a fair hearing and I think we've had an opportunity to outline our key issues. They are detailed in the submission and there are some we haven't touched on today that we're happy to discuss out of session or by whatever means, and similarly, if there is a need for further clarification on some of the points we've made in the submission, we're more than happy to provide

that, noting the tight time frame of the review itself. Anything that assists clarify we are happy to assist with.

MR HINTON: Thank you very much for that, and thank you again for your appearance and participation today and, of course, your previous submissions, very substantive submissions. Thanks again.

MR BEASLEY: Thank you.

MR HINTON: That concludes today's scheduled proceedings. However, as foreshadowed, and in accordance with the Commission's established procedures, I now provide an opportunity for anyone else who is present to make a statement if they so wish. The usual conditions apply. If you wish to, you need to identify yourself and come to a microphone so that it can be recorded on transcript. Deathly silence was the clear response. I will adjourn these proceedings. I thank everyone again for their attendance and participation and note that we will resume the hearings in Adelaide on 31 March - that is next week. Thanks very much.

AT 3.07 PM THE INQUIRY WAS ADJOURNED UNTIL
WEDNESDAY, 31 MARCH 2004