

14 June 2001

Mr Gary Banks
Chairman Productivity Commission
PO Box 80
BELCONNEN ACT 2616

Dear Mr Banks

National Access Regime Inquiry

Thank you for the opportunity to present to the Inquiry yesterday in Brisbane.

As is now all too common, it was not until after the presentation that the following thoughts on 'access holidays' and 'building blocks' came to me. I hope they are of some use.

Access holidays

You asked a question regarding the appropriate length of an access holiday for risky or greenfield investments. Because each project is different it is difficult to come up with a 'one size fits all'. In this context I wonder if the idea of adopting regulation based on the Petroleum Resource Rent Tax could be married to the concept of an access holiday -- the length of the access holiday would be a function of the project's actual cash flows and be equal to the time it takes for the project to be NPV zero (with actual cash flows discounted by the regulatory cost of capital). If this approach was taken it would be important to establish now the principle that the benefits that accrue after the holiday is over are to be shared on a pre-agreed basis (eg 60:40).

Building Block Approach

I think there was a hint in some discussion yesterday that a 'building block' approach is undesirable per se.

It is our view that any pricing which is cost based, or which requires some check against cost, will rely on a building block approach. For example, if a price-cap system was adopted and it was necessary to check how such prices related to cost at the next reset a building block approach would be used to assess cost (cost might be calculated as operating cost + depreciation + (Cost of capital * Regulatory Asset Base)).

Some parties will be critical of 'building blocks' for the very reason that they imply that prices be cost based. However others are critical of 'building blocks' because they associate building block pricing with prices based on regulator estimates of 'efficient' costs. The real focus of criticism for this second group is not 'building blocks' per se, but the fact that regulator estimates of 'efficient' costs are employed to determine regulated prices.

I hope the above thoughts are of some use. In addition, I do recognise that you had little opportunity to question me on my presentation – because I used up all the time, and because you had not seen the presentation beforehand. I would be happy to answer any additional questions you might have.

Yours truly

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