Productivity Commission - Review of the National Access Regime

General Comments

Duke Energy International (DEI) strongly supports the overall thrust of the Productivity Commission's position paper on the Review of the National Access Regime. Clearly, the Commission faced a significant challenge in attempting to prepare a position paper that does not trivialise this complex area while at the same time not getting lost in unnecessary detail. While DEI wishes to commend the Commission on its efforts it is nevertheless felt that the position paper misses the opportunity to consistently convey the key overarching principles that DEI believes the Commission intended.

The Commission's position paper initially clearly enunciates the two-stage nature of the existing regulatory framework. Namely, that in the first instance assessment is made as to whether a particular service or facility should be declared for third party access purposes. The second part of the framework only applies to those services that pass the coverage test. The position paper acknowledges that this two stage process has been established in recognition of the fact that providing regulated access is a second best solution that should only apply in circumstances where negotiated, market based access to services cannot be achieved.

However, it is felt that this clear recognition of the two stage process progressively fades as the position paper is developed and that the critical position of the coverage test in ensuring that the regulatory framework is not excessively intrusive in terms of coverage is lost. It is DEI's strong contention that the single most critical factor in the national access regime is to ensure application is limited to circumstances where there is clear misuse of market power and therefore, where there will be significant net economy wide efficiency benefits. While the Commission's requirement to address the second part of the framework is appreciated, it is felt that the report could have benefited from reiterating the residual nature of the detailed regulatory framework and the fact that it should only apply in appropriately limited circumstances.

Impact of Current Regulatory Regime

From DEI's perspective, the problem with the current access regime and in particular the National Third Party Access Code for Natural Gas Pipeline Systems (the Code), is the prescriptive manner in which the Code has been implemented removes from management the ability and responsibility to truly commercially manage the pipeline business. Prescriptive regulation of the type delivered by the current regime promotes a management focus on optimising regulatory outcomes at the expense of the pursuit of innovative entrepreneurial management. Such management is critical to ensuring Australia's long-term international competitiveness.

An associated negative impact of the current regime under the Code is that the regulator (the ACCC) is forced to adopt a customer advocacy role by virtue of the fact that it is interposed between the service provider and the end customer in its role of establishing terms and conditions of access. This effectively limits the possibility of appropriate market based solutions arising from open negotiation between access seekers and service providers and results in the loss of the information content inherent in the market signals provided by such negotiations.

In addition, operators of assets regulated under the Code are faced with a series of direct financial and non-financial costs. The prescriptive nature of the regulatory regime results in the need for regulated asset owners to establish fully resourced teams to interface with the regulator. Such teams can become a significant cost in their own right. Further, the regulatory regime may impose unnecessary delays in areas such as the need to seek approval prior to establishing affiliate contracts or regulators may require a level of disclosure of commercial contract information (such as foundation customer agreements) which is of concern to potential customers. Such delays and information requirements can potentially result in the loss of business opportunities.

Concerns over the application of industry specific regimes mean that the question must be asked as to whether specific regimes such as the Gas Code are truly required. While DEI accepts the need for an overarching national access regime for situations where there is a clear misuse of market power, it is considered that Part IIIA adequately satisfies this requirement and that industry specific regimes such as the Code merely add an additional unnecessary layer of regulation which has proven to be both overly prescriptive and costly. As such, DEI believes that in the limited circumstances where regulated access to pipeline services is justified, it should be achieved via the national access regime rather than the Code.

Asymmetric impact on returns

For those facilities covered by the regulatory regime, the asymmetric impact of regulation as it is currently implemented in Australia is of major concern. In particular, access regulation effectively provides a cap or upper limit on the returns that a service provider may achieve while failing to provide an offsetting guarantee that returns will not fall below the regulated target. This asymmetry creates an extreme disincentive to entrepreneurial investment especially as it applies to marginal greenfields projects.

At a minimum, this will result in a delay in marginal projects being established (until the down-side risks are assessed to be at an acceptable level), or may result in the development of infrastructure sized to meet short term market requirements with no expansion capacity to allow for possible market growth. As the Commission has already recognised, the short term benefits to consumers from reduced access prices (assuming that consumers are able to capture these benefits and that they are not simply absorbed by unregulated upstream or downstream components of the value chain) are likely to be more than offset by the long-term impact of inadequate infrastructure investment.

Actual evidence of the impact of regulation on investment will always be difficult to collect and will be subject to interpretation. Indeed, it may not be possible to clearly separate the stand-alone impact of regulation due to the number of other commercial factors that potentially impact on the decision of whether to proceed with an infrastructure investment.

Access holidays

With respect to access holidays, DEI does not consider them to be a solution to the regulatory risk associated with new projects unless they are in effect a perpetual null undertaking (that is, for the life of the asset). Anything less than a perpetual holiday will mean that the service provider remains uncovered early in the assets life while the majority of the project risks are being resolved and will be covered at a time when the project may be achieving its potential. This issue goes to the heart of the risk reward trade-off and the inevitable tendency of regulators to assess individual cases on an ex-post basis at the time that any access arrangement is being assessed without taking into account the ex-ante circumstances faced by the infrastructure developer at the time the investment was being proposed.

As such, DEI considers that the aim of access holidays can best be achieved through a thorough review of the coverage criteria. This review is in line with the Commission's Tier 2 proposal.

Pricing Principles

The Commission has questioned whether the introduction of pricing principles would provide increased regulatory certainty. It is DEI's view that while the introduction of pricing principles is unlikely to have any negative impact on the regulatory framework, it is unlikely to lead to any significant reduction in regulatory risk. This is due to the fact that in order to be acceptable and applicable in all circumstances, these principles will need to be pitched at a high level and as such, are unlikely to significantly constrain regulatory discretion and therefore will not provide adequate certainty to service providers.

Cost of Regulation

As previously noted, DEI believes that the most significant impact of regulation is its potential negative impact on management behaviour. This impact is likely to be reflected in long term reductions in economy wide allocative and, in particular, dynamic efficiency.

With respect to the direct cost of regulation, DEI would like to point out that the lack of clarity associated with the current coverage criteria under the Code and the resulting need to appeal the Minister's coverage decision on the Eastern Gas Pipeline to the Australian Competition Tribunal cost DEI in the order of $3 million. The tightening and clarification of the coverage criteria under Part IIIA together with flow on revision of the Code criteria should reduce the need for such appeals in the future.

Summary

In conclusion, DEI believes that revision of the coverage criteria is essential, initially in the form of the Commission's Tier 1 proposal followed, in the medium term, by the Commission's more comprehensive Tier 2 proposal. It is only by undertaking such a revision that the original public policy intent can be achieved. Namely, of providing regulated access to significant infrastructure in circumstances where negotiated access can not be achieved on reasonable commercial terms. It is only in such circumstances where there is a clear misuse of market power that there is likely to be significant economy wide efficiency benefits associated with enforced access. DEI feels strongly that service providers should be given the opportunity to exhibit, via their behaviour, that they will not misuse market power. In this context, the ever-present threat of a future successful coverage application by an aggrieved third party is likely to act as a significant guarantee of appropriate behaviour.

DEI believes that its own commitment to operating pipelines on a transparent, non-discriminatory, open-access basis removes the need for regulated access as under no circumstances would enforced access increase competition or, more importantly, efficiency in any associated market.

Finally, in order to capture the benefits of the Commission's review, it is essential that where industry specific regimes continue to exist, they are revised to fully reflect any changes to Part IIIA.