"THE REGULATION GAME"

THIRD PARTY ACCESS TO AGL GAS NETWORKS- A CASE STUDY OF REGULATORY GAMING

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Executive Summary

The report draws lessons from the two gas distribution pipelines access reviews in New South Wales.

Regulatory processes and procedures are examined, in particular the 22 months second access review in 1999/2000 and the less than satisfactory first access review conducted in 1996/97.

The Tribunal's approach appears to give a large weighting to balancing the interests of customers and owners, whilst users have emphasised the need to uphold Code provisions,

The 1999/2000 regulatory processes involved were lengthy and resource-intensive. Over 18 months, a piecemeal collection of information and amendments regarding the Access Arrangement and Access Arrangement Information was provided. Information disclosure was a closely-contested issue and substantial delay resulted as the Tribunal issued formal requests for better information, including considerations in making it publicly available. The access review degenerated into 'cat and mouse' regulation.

The 1996/97 access review was unsatisfactory because of information deficiencies and an incomplete picture was obtained, especially on asset values, costs and cost allocations. But all the revealed deficiencies were promised to be rectified by the time of the second access review. Users, however, were to be disappointed.

Users concerns were directed at issues such as transitional revenues permitted, users' capital contributions, asset valuations, corporate restructuring, and at aspects of the Tribunal's approach to some of these issues.

Difficulties in regulating a vertically-integrated business are highlighted and suggestions made for improvements, especially to the Code to minimise regulatory gaming practices. The Code may need strengthening, particularly in areas where the regulator may require when and how regulatory charts of accounts are to be presented.

Experience shows that a 'light' approach to regulation in NSW would have disadvantaged consumers and potential competitors even more.

1. Introduction

The objective of this report is to draw lessons from the two gas distribution pipelines access review experiences in New South Wales in 1996/97 and in 1999/2000 and to point the way forward to enable the efficient implementation of future access arrangements in gas pipelines (and perhaps other economic infrastructure services).

The report examines the experience in New South Wales in introducing third party access to the monopoly gas distribution pipelines (owned by AGL Gas Network Limited) in the State. The report is more an examination of the regulatory processes and procedures than of the details of the regulatory determinations and outcomes

The particular experiences of access arrangements review in New South Wales in 1999/2000 may be encapsulated in the following comments from the Chairman of the Independent Pricing and Regulatory Tribunal of New South Wales, Dr Thomas Parry:

> "The process for considering AGLGN's revised Access Arrangement has extended over some 18 months. This is far too long! This has reflected a variety of factors, including the particular requirements of the Code. There is a strong argument for exploring opportunities for streamlining some of the requirements of the Code, without detracting from the legitimate rights of all parties to fully participate in the process.
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> Following extensive further consultation and analysis since the release of its draft decision, the Tribunal still requires, inter alia, revision of the initial capital bases (ICB) proposed by AGLGN; the rate of return underpinning the annual revenue requirement and resultant prices proposed in AGLGN's revised Access Arrangement. The Tribunal will also require downward revision of AGLGN's non-capital cost projections and some of its capital expenditure items.
>
> There also has been considerable work undertaken on cost allocations and alternative tariff scenarios. Transportation charges represent a significant cost for customers and the Tribunal is concerned to ensure, inter alia, that customers pay no more than is appropriate for the use of the AGLGN distribution system."
>
> **(Final Decision Access Arrangement For AGL Gas Networks Limited Natural Gas System In NSW. July 2000, Foreword, page (i)).**

Following further delays, the Tribunal finally approved AGLGN's revised Access Arrangement and Access Arrangement Information (which incorporated the amendments specified in the Tribunal's final decision) in September 2000 and the regime came into effect on 1 October 2000 – 22 months after AGLGN submitted its proposed Access Arrangement to the Tribunal in January 1999 and 14 months after the expected date for commencement of the access regime (July 1999). This was the Tribunal's second access review concerning AGLGN; the first access review was conducted in 1996 and 1997.

2 Regulatory Gaming Or Regulatory Intrusion? The Consumer's Interests

The Tribunal's approach in its 1996/97 and 1999/2000 access review of AGLGN emphasized the development of upstream and downstream competition in the gas industry, and in seeking to achieve that, its underlying philosophy in both access reviews appears to be focused on balancing the interests of customers and network owners:-

> "Access arrangements need to balance the interests of customers and infrastructure owners. This is emphasised by the Hilmer report which states that,
>
> 'Neither the application of economic theory nor general notions of fairness provide a clear answer as to the appropriate access fee in all circumstances. Policy judgements are involved as to where to strike the balance between the owner's interest in receiving a high price, including monopoly rents that might otherwise be obtainable, and the user's interest in paying a low price, perhaps limited by the marginal costs associated with providing access. Appropriate access prices may depend on factors such as the extent the facility's existing capacity is being used, firmly planned future. utilisation and the extent to which the capital costs of producing the facility have already been recovered".
>
> This emphasis on balancing the interests of the various parties is reflected in the Competition Principles Agreement (CPA). Under the CPA, the arbitrator in an access dispute is required to consider, among other matters:
>
> - the owner's legitimate business interests
> - the cost of providing access (excluding losses arising from increased competition)
> - the interests of all persons with contracts to use the facility
> - the public benefit from competitive markets.

The National Competition Council has stated that,

> "One of the challenges for access regulation is to balance the commercial interests of infrastructure operators with those of businesses seeking to enter and compete in upstream and downstream markets."

The Tribunal recognises that there will be some tension between the interests of the service provider and potential users."

(Access To The Distribution Network Of AGL Gas Companies (NSW) Limited: A Progress Report From The Secretariat, November 1996)

In contrast, the objective of the National Third Party Access Code for Natural Gas Pipeline System (The Gas Code) in specifically targeting the promotion of gas competition, also emphasizes the prevention of monopoly power and sets clear objectives to guide regulators:-

"to establish a framework for third party access to gas pipelines that:

(a) facilitates the development and operation of a national market for natural gas; and
(b) prevents abuse of monopoly power; and
(c) promotes a competitive market for natural gas in which customers may choose suppliers, including producers, retailers and traders; and
(d) provides rights of access to natural gas pipelines on conditions that are fair and reasonable for both Service Providers and Users; and
(e) provides for resolution of disputes."

This is an important point to note. That is, in order to promote competition, the Code requires the regulator to ensure that the network owner has included in its regulated monopoly revenues only those (legitimate) costs representing its monopoly services (e.g. excluding excessive marketing costs or corporate overhead costs devoted to its diversified, non-regulated businesses) and not to undertake discriminatory/predatory pricing to give its affiliates unfair advantage.

Indeed, in almost every submission from major users' groups and organisations, the regulator was reminded of the need to uphold the Code provisions (including the foregoing objectives). From the users' perspective, the Code (and its provisions) provide an essential legislative anchor for efficient economic regulation of a vertically-integrated business. The challenge has been to persuade the regulator that "the concept of light-handed regulation does not imply a "light" approach to details and transparent investigations into AGLGN's actions and the formulation of its prices."

(Seeking Genuine Gas Competition In NSW, NERA, 18 February, 2000)

The processes involving the 1999/2000 review were lengthy and resource-intensive and included the following AGLGN proposals, non-confidential submissions, and public hearings:-

- advertisement of the proposed Access Arrangement (AA) and Access Arrangement Information (AAI) for public comment on 5 January 1999;
- AGLGN issued a Revised AAI updating January AAI and incorporating forecasts in response to s2.9 of the Code notice on 8 February 1999;
- Public hearings held on 31 March and 1 April 1999;
- AGLGN issued a Supplementary AAI in response to further s2.9 notice on 16 April 1999;
- AGLGN response to matters raised in submissions and hearings;
- Pricing forum on Revised AAI held on 16 June 1999;
- AGLGN issued Corrections to Revised AAI and Supplementary AAI cost breakdown and capital expenditure on 23 June 1999;
- AGLGN further submission (benchmaking gas distribution) on 21 July 1999;
- AGLGN further submission (reasonable expectations under prior regulators regime) on 23 July 1999;
- AGLGN further revisions (on ICB, capital expenditure forecast) and Arthur Anderson report on financial analysis on 4 August 1999;
- AGLGN further submission (new trunk reference prices proposal) on 11 August 1999;
- AGLGN further submission (windfall gains and revaluations of ICB) on 11 August 1999;
- AGLGN further submission (response to issues arising from new trunk charge proposal) on 20 August 1999;
- Release of the Tribunal's draft decision on 23 October 1999;
- AGLGN provided its responding submission of 30 November 1999;
- Public forum held on 10 and 24 February 2000;
- AGLGN provided further submissions in February and March 2000;
- AGLGN disclosed further information in response to Tribunal;
- Release of the Tribunal's final decision on 21 July 2000;
- AGLGN sought extension of time to submit revised AAI on 29 August 2000;
- AGLGN submitted revised AA and AAI on 7 September 2000 for approval;
- Tribunal announced approval of AGLGN's revised AA on 19 September 2000;
- Access Regime commences on 1 October 2000.

Several observations could be made regarding the extended review process:-

- There was persistent failure on the part of AGLGN to submit its proposed AA and AAI in accordance to the Code;
- A piecemeal collection of information was provided over a period of 18 months and then a failure to provide a consolidated AA and AAI notwithstanding very substantial amendments to the initial AA and AAI during the course of the review;
- Reasonable concerns (and confusion) on the part of consumers with AGLGN's access proposals involving three significant changes to pricing structures in three years (from post codes to zones, and then to post codes), with very substantial and complex changes (involving revenue and cost shifting);
- Selective adoption of the Tribunal's draft decision, while ignoring substantial requirements;
- During the review process, AGLGN submitted responses to two section 2.9(a) (of the Code) notices from IPART and provided further information in response to Section 41 (of the Gas Pipelines Access Law) requests issued by the Tribunal;
- Following public consultations, the Tribunal released information on operating costs for contract customers on a fully distributed methodology under Section 42 (2) of the Gas Pipelines Access Law (AGLGN had stated the information was confidential and commercially sensitive);
- The critical importance of informed public consultations, which helped draw attention to significant deficiencies in the proposed AA and AAI;
- The degeneration of the access review into 'cat and mouse' regulation.

Boxes 1, 2 and 3 provide examples of the deficiencies expressed by many users in AGLGN's AA and AAI and the review process.

Box 1

Information Disclosure and Statutory Obligation to Consult Properly

"Despite engaging the best advice on the subject matter, information anomalies and missing data in the information provided by AGLGN have prevented BHP from making a complete and precise recommendation as to what the required revenue and detailed pricing should be. The information anomalies and missing data have been compounded by approaches which have been adopted by AGLGN that are inconsistent with the Code.

In short, BHP cannot understand the derivation of key elements of the proposed revisions. For example:

- For detailed prices there is little that would enable a user to both understand how the prices are derived, replicate the calculations or otherwise determine whether the Code has been complied with in deriving the prices.
- For the high pressure system there is no evidence of the DAC valuation or the derivation of DORC.
- In 1997 the network DAC valuation for July 1996 was stated as being $700 million. In the 1999 network DAC valuation, the valuation for July 1996 has been restated at $967 million without explanation.
- The capex forecast is inconsistent with the JP Kenny unit rates. If the capex forecast is correct, the JP Kenny ORC estimate may be substantially overstated.
- For the high pressure system, there is no transparent allocation of opex and G & A expenses by pricing zone.
- The asset valuations refer to negative working capital of $199 million in July 1999 as part of the ICB (AAI p.17). The nature of the negative working capital that will be operative in July this year is not explained and is not readily understood.
- The disaggregated operating costs include a category of "other cost (including customer connections)" which is shown as a negative cost of $23.1 million in 1999 (AAI p.66). This has not been explained and is not readily understood.

In determining whether to accede to this request, IPART should recall that there were a substantial number of "mistakes" of fact made by AGLGN in the last review process. The level of non-disclosure by AGLGN in 1996 and 1997 meant that users (and potentially IPART) were not in a position to fully identify those errors. The extent of those mistakes was material, even drastic in magnitude ($300 million according to AGLGN, AAI p. 15)."

Source: BHP Submission To IPART. 16 March 1999.

Box 2

AGLGN Access Arrangements

I am writing to express our strong disappointment with AGLGN's failure to comply with the Tribunal's Draft Decision and with the provisions of the National Third Party Access Code For Natural Gas Pipeline Systems.

In the Tribunal's Draft Decisions released in October 1999, the Tribunal stated:-

> ***"Amendment 1-Access Arrangement Information (chapter3) –*** AGLGN is required to amend the Access Arrangement Information to provide a consistent and complete compilation of:-
>
> a) information already provided and to include additional information.
> b) changes made in response to the proposed amendments set out in the draft decision.
> c) actual results in 1998/99 including capital costs, non-capital costs, system capacity, sales volume, MDQ, and key performance indicators.
> d) cost allocation information consistent with the revisions to pricing required by the decision."

At the Public Forum on 10 February, major customers complained that the AGLG documentation (made available 2 days before the Public Forum) did not fully comply with the Tribunal's Draft Decision, especially with respect to Amendment 1 – Access Arrangement Information.

We believe AGLGN's response also fails to comply with Section 2.8 of the National Third Party Access Code. We consider the Tribunal has the powers to obtain the necessary information.

It is worth recalling that the Tribunal's Draft Decision for a consistent and complete access arrangement information reflected many interested parties' concerns that the extensive changes in the documentation submitted by AGLGN during the past year made it difficult to enable users to derive reference tariffs because of the incompleteness of the information, the changes made, and the inconsistencies of data contained in the documents.

We are also concerned that the Tribunal has, to date, not reach a decision on its review of AGLGN's cost allocation in relation to the information disclosure provisions of the Gas Pipelines Access Law (section 41 and 42). We believe that this matter has been under consideration by IPART for 6 months or longer.

Many customers have made submissions requesting that relevant information be made available so that they can be satisfied (under the National Gas Code) that their transportation charges are fair and reasonable and can be derived and established from information and data provided by AGLGN.

We wish to reiterate to the Tribunal that major customers continue to contest the appropriate level of contract market revenues. We consider that the appropriate level (first year) is in the range of $17 million to $29 million, far below the $47 million arrived at by the Tribunal in its Draft Decision, and that the standalone pricing methodology used by AGLGN is not permitted under the Code in these circumstances. For this reason, it is incumbent upon the Tribunal to ensure that AGLGN be required to comply with the requirements of the Draft Decision, and that the Tribunal arrives at a decision on its review of disclosure of AGLGN cost data under sections 41 and 42 of the Gas Pipelines Access Law.

The efficacy of the NSW Third Party Access Regime For Natural Gas Pipelines is currently under serious questioning in light of the wasteful duplication of pipelines in the State:-

- Duke Energy: Wilton to Horsley Park
- Integral Energy: Camden and Nowra

The Tribunal has the task and the opportunity to bring in a Final Decision on AGLGN which provides for an efficient and acceptable basis for third party access to gas pipelines in New South Wales that makes such duplicate pipelines unnecessary. We consider that the process currently in train does not satisfy IPART's obligations and will not deliver the right outcome if AGLGN is allowed to selectively comply with the Tribunal's requirements and transparency and disclosure of information is restrained.

Source: Energy Markets Reform Forum Submission To IPART. February 2000.

Box 3

Information Disclosure And Compliance

"AGL(GN) has selectively complied with the draft decision. In addition to reserving its position on the key aspects of the draft decision, AGL(GN) elected not to comply with a number of IPART's required amendments:

IPART Amendments	**AGL(GN)**
Submit consolidated AAI	Not complied
Submit 1999 actual volumes and costs	Not complied
Unbundle transmission and distribution	Not complied with, except in Wollongong
Offer non-discriminatory tariffs on the lines	Not complied. Discrimination between different gas users remains
Provide separate opex for each covered pipeline	Not complied. Opex is allocated, not actual
Provide separate capital base for each covered pipeline	Central West capital is combined with local network in roll forward

This response has frustrated IPART's stated purpose. Stakeholders cannot comment on the overall effect of the draft decision, only on the effect of a selective adoption of the draft decision. Further, stakeholders have waited 4 months for AGL(GN) to provide a selective response to a draft decision, while Users still have fundamental concerns with the draft decision that have not been answered by IPART. Stakeholders have been given less than 4 weeks to respond."

Source: BHP Submission To IPART. 27 March 2000.

Any review process, extending over 22 months, necessarily involves the commitment of substantial resources, both financial and human, by the regulator, the access applicant and other stakeholders, especially customers. In addition to the legal, economic and financial complexities of AA's and AAI's, users are particularly disadvantaged by the lack of resources to enable effective participation in extended reviews of such nature. The access arrangement applicant has obvious financial incentives to mobilize resources to seek favourable outcomes. In any case, the costs incurred are paid for by users of the network, as the regulator allocates such costs to the regulated revenues. In the AGLGN case, its AAI indicates incurring costs for 'regulatory relationships' in excess of $1 million.

But a greater financial advantage is obtained by the access arrangement applicant for delays in the implementation of the new access regime: AGLGN's previous access undertaking was scheduled to expire on 30 June 1999 and under the interim NSW Code, it was envisaged that before that date, a new Access Undertaking would have been approved. This did not occur, and the NSW Government was obliged to introduce regulations to continue the previous AGLGN access undertaking (including prices, terms and conditions) beyond 30 June 1999 until the latest review was completed (i.e until 30 September 2000). The delay in effect meant a financial windfall to AGLGN and financial penalties for users. Also insidious was the discouragement to users whose contracts were falling due (because of business decisions based on the previous understanding that a new access regime would come into force on 1 July 1999) to enter into transportation and gas contracts with third parties ahead of a new access regime operating. In other words, the delay had anti-competitive implications and impacts.

3. The 1997 IPART Final Decision

In the Tribunal's Final Decision on AGLGN's first proposed Access Undertaking in 1997 the Tribunal took "considerable care to stress that the current estimate of contract market costs is a "staging point" and not a definitive finding concerning the costs of serving the contract market" **(IPART AGL Gas Networks Limited Access Undertaking (as varied) Determination, July 1997, Page 5).** The Tribunal admitted that its Final Decision was deficient, and promised that at its next review in 1999, it would ensure:-

- ◊ "extensive information gathering and analysis will take place" (page 5);
- ◊ "seek to confirm contract market costs and the magnitude of the cross subsidy" (page 5);
- ◊ "A critical matter for the success of the next review will be the availability of adequate information. The Tribunal has required AGLGN to develop information systems which will provide cost information of sufficient detail and reliability to enable a move robust cost analysis. AGL has agreed to work in co-operation with the Tribunal to develop information systems that accommodate the needs of the revised structure of the business and to facilitate

a move definitive calculation of AGL's revenue requirements and asset values for the next review."(page 5);

- ◊ "Perhaps the most important analysis to be performed before the next review will be study of the Price Control Formula applicable to the tariff market. In the absence of such a review, the Tribunal has been unable to reach meaningful conclusions regarding the appropriate sharing of joint and common costs between the contract and tariff markets……(and) the findings will be critical to determining an asset value applicable to the medium/low pressure system, and ultimately the asset value for the composite system." (page 6);
- ◊ "It was noted that the information available from AGL's accounting records was not sufficient to facilitate the accumulation of cost on a discrete activity basis." (page 39);
- ◊ "Comments received from users and customers indicated that this pricing structure involved a level of averaging that was unacceptable. The degree of averaging of primary and secondary system cost and the roll in of some local network costs into the trunk cost concerned some users." (page 42);
- ◊ "The Reference Tariffs did not include any cost of services provided by the medium and low pressure systems." (page 42);
- ◊ "The Tribunal considers that the $1,200m Initial Capital Base established in the draft Determination requires review. That asset valuation was based on a price path which the market regard as unacceptable. This value contains retail costs ….. and does not consider further optimisation." (page 66);
- ◊ "The Tribunal now considers that the revenue stream utilised in the September 1996 present value analysis overstated the sustainable revenue stream on three counts. First, the network revenue in that analysis included retail costs and margins. Second, the present value analysis included revenues collected during the transitional period ….. Third, the September 1996 analysis did not adequately reflect the potential for cost savings in the network, as identified in the Greenwood Challoner (consultancy) report." (page 70);
- ◊ "…….. the Tribunal expects that user contributions will be reflected in the price for service to the contributing user. Assets funded from user contributions will not be included in the Capital Base for regulatory purposes." (page 71);

It is worth placing on the record that major gas users' and user groups had extensive consultations with the Tribunal Secretariat and that prior to the Tribunal's Final Determination in July 1997, the Business Council of Australia Energy Working Group lodged a submission with the Tribunal which, inter alia, pointed to deficiencies in the Tribunal's Draft Determination, and sought IPART's co-operation in addressing the deficiencies (e.g. absence of appropriate regulatory chart of accounts, public review of any extension of transitional revenues beyond 1999, the need to set up the key activities, timelines and milestones for the 1999 review process) prior to the next access review. A copy of the submission is in Attachment A. The general view of users at that time was that notwithstanding the substantial deficiencies in the Tribunal's draft decision (reflecting in the main, deficiencies in information and insufficient analysis) there should not be further delays to implementing the access regime. The clear understanding reached was that lessons had been learned and proper procedures and requirements would be put into place prior to

1999 so that the next AGLGN AA and AAI would be properly assessed against the provisions and requirements of the Code.

Many, if not most of the difficulties encountered during the 1999/2000 review were anticipated in the Business Council of Australia Energy Working Group submission, notwithstanding that those views were to a large degree accepted by the Tribunal in its 1997 Final Determination.

The establishment of the IPART Gas Industry Consultation Group (announced in the Final Determination) and its on-going activities over 1997 and 1998 gave promise that the majority of the deficiencies identified in the first access review have been appreciated by the Tribunal (and AGLGN!) and that the next review held promise for a transparent, accountable, rigorous review, consistent with Code provisions and users' expectations. Alas, users and IPART were disappointed. As pointed out in the earlier sections, AGLGN took a different approach, notwithstanding an earlier agreement with the Tribunal on certain undertakings, such as improving information systems and information disclosures. But even more disappointing was the failure (in 2000) on the part of the Tribunal to deal with issues it said it would do in its 1997 Final Decision. The treatment of users' capital contributions is an example (see later).

4. Gas Pipelines Competition In NSW

> "It is obvious that [competition] could be – indeed typically is – excessive from the standpoint of the seller. This distinction, while obvious, is worth emphasing in the present context. All competition is "destructive" of the equity of the individual businessman who is subjected to it. That is why businessmen who will rarely ……. declare opposition to competition as a general practice will ordinarily hasten to express their objection to competition that is "destructive," "excessive," or "cut-throat," and it is ordinarily difficult to see what price competition they would not so characterise." **(Professor Alfred Kahn. The Economics of Regulation (1971), Volume 2, page 173).**

The perspective provided by Professor Kahn, perhaps, explains the sequence of events/delays encountered in access regulation in NSW since the first draft proposed access arrangement by AGLGN in May 1996. Where a firm has a natural or de facto monopoly (and in the absence of efficient economic regulation) it would have the ability to exercise market power in a manner unchecked by competition. It would seek to maximise profits rather than total social welfare, and it would seek to minimise competition or any competitive threat. It would seek to delay, prevaricate, and do everything in it power to uphold shareholders' value.

The implementation of economic regulation (via the Gas Code) is thus intended to protect customers from the exercise of monopoly power (at the same time as protecting the legitimate business interests of the asset owners). The objective of economic regulation is also aimed at "protecting competition" i.e. to ensure that incumbent owners do not frustrate or interfere with genuine competition.

As history has shown, the (incomplete) 1997 Final Determination did not live up to expectations and there was a lot of unfinished business, in terms of adequacy of costs data and difficulties in assessing the reasonableness of costs. In a BHP commissioned NERA report, **Seeking Genuine Gas Competition In NSW (February 2000),** it was stated that:-

> "The future of Gas Competition in NSW is uncertain because of the vertical integration of Australian Gas Light Gas Networks (AGLGN) and because no body in NSW appears responsible for ensuring a level competitive playing field. Neither the Australian Competition and Consumer Commission (ACCC), nor the Ministry of Energy and Utilities (MEU), nor the Independent Pricing and Regulatory Tribunal (IPART) fill this function.
>
> The competitive prospects for NSW should be strong, as gas supplies flow into the state from at least two distinct sources through three pipelines. Yet barriers to competitive access, enhanced by the vertical integration of AGL (AGLGN's parent), exist on all three routes.
>
> 1. The access arrangement of Eastern Australian Pipeline (EAPL) from the Cooper Basin, controlled by AGL, does not present competitors with a level playing field.
> 2. The intercontection with Victoria (also controlled by AGL) is not a significant source of competitive supply to NSW, partly because of the prices and access terms available.
> 3. The new supply route from the Bass Strait has confronted at least $28 million in competitive entry barriers, to date.
>
> The common obstacle to competitive gas access in NSW is the vertical integration of AGL, which controls the trunk and reticulation networks (which virtually all customers in the Sydney region must use) as well as unregulated businesses and long-distance upstream pipelines. AGL has powerful incentives to prevent competition for two basic reasons:-
>
> - AGL has the major equity interest in the Moomba-Sydney pipeline with which the other routes compete.
> - AGL sells gas to the great majority of NSW gas users and would complete with other open-access gas sellers if those others had fair access to gas users.

> Faced with this potential for competition against its affiliates, AGLGN pursues actions that limit its exposure to competition and frustrate market entrants. AGLGN is raising the costs for the new entrants into NSW, proposing charging practices that give AGLGN the ability to discriminate against competitors and blur the separation between its regulated and unregulated businesses." (page 1 and 2)

The NERA report pointed to the US and UK experiencing similar problems in the early years of their gas open access programs, but the UK adopted voluntary de-merger of British Gas into separate gas pipeline and merchant activities. On the other hand, the US adopted "much more careful regulation of existing affiliate relationships, open access rules and tariff design formulas than either IPART or the ACCC has undertaken to date vis-à-vis the Code."(page 2).

NERA further suggested that:-

> "The most practical solutions involve more explicit and effective regulation of AGLGN by IPART (or another agency) as part of more serious attention to the implementation of the Code's competitive intent. The solutions must accomplish the following objectives:
>
> * Prevent the raising of naked entry barriers, represented by the additional $28 million spent by Duke International to duplicate an AGLGN line. (The by-pass duplication was, in the event, built).
> * Prevent the cross-subsidisation of AGL's competitive business through much better regulatory accounting and scrutiny of AGLGN's affiliate transactions and relationships.
> * Prevent AGLGN from taking non-tariff customer contributions without compensating those customers, a potent source of discrimination, entry barriers and tariff cap evasion. (The IPART Final Decision ignored users' capital contributions).
> * Improve transparency and tariff predictability for users by making tariff models and the data that support them public. A regulated company is not justified in claiming that the data that support its regulated tariffs are confidential (as AGLGN has done under its proposed Access Arrangement). (IPART obtained and subsequently released fully distributed cost information for the contract market over 12 months after the draft proposed access arrangement was lodged by AGLGN in January 1999)."(page 2).

The above illustrate the obvious remedies for engendering more effective competition in NSW (against the background of a vertically-integrated business such as AGL) and were frequently put by interested parties in submissions to the Tribunal:-

i. the need for transparency and provision of adequate information for the regulator and users in a timely fashion;
ii. to prevent reloading and rolling-in of costs, sufficient information on costs and tariff models are required and need to be widely available;
iii. effective ring-fencing enforcement to prevent cross-subsidisation of AGL's competitive businesses (IPART's October 1999 draft decision completely ignored affiliate transactions although it had issued a Section 41 notice to the AGL group in regard to group charges to AGLGN and claimed that it had considered this additional information);
iv. the need to identify spare capacity through a public register;
v. regulating the type and size of capital contributions to help prevent price discrimination and evasion of pricing controls. The Code currently disallows the monopoly pipeline to collect more than its cost from a customer without transparent criteria for doing so. Customer contribution are a regulatory issue with wide competitive, tariff and policy implications; it should be dealt with in the regulatory review and should not be ignored by the regulator and left to arbitration.

The NERA report would seem to suggest that there is a gap in regulatory responsibility in NSW on the significant issue of hindrance of competition. Indeed the experience of the 1999/2000 access review clearly shows the adverse impacts on competition and consumers. However, experience also suggests apparent concerns held by the regulator to avoid additional regulatory costs pertaining to the type of regulatory scrutiny necessary with perhaps insufficient weight given to the consequences for customers, for competition, and for confidence in an effective and credible regulatory model. Again, the remedy is obvious, i.e. 'light handed' regulation requires transparent regulation and disclosure of sufficient information on costs and tariff models. Finally, the setting of revenue caps should be supported by regulatory pricing principles to prevent price discrimination and unfair pricing practices (as events since the Approval of the AGLGN AA and AAI have revealed).

5. Information Disclosure

The Tribunal stated in its Final Decision in July 2000 that "Throughout the review process, most interested parties have expressed concerns with the content of AGLGN's Access Arrangement Information (AAI) and the level of information disclosure."(page 7). Yet, despite IPART's Draft Decision, which inter alia, required amendments in the AAI to reflect changes required, AGLGN was able to avoid providing the necessary information amendments to its AAI because it

disagreed with the Tribunal and here was a claim that the Tribunal was powerless under the Code. This information was only provided after the Tribunal made its Final Decision and only on 7 September 2000 when AGLGN submitted its revised AA and AAI for approval. This meant that the Tribunal presumably made its Final Decision without the benefit of the information being properly disclosed by AGLGN (and with users also in the dark). The information involved was very substantial and significant:-

> "Amendment 1 - Information disclosure in AGLGN's Access Arrangement information (chapter 3)
>
> 1.1 AGLGN must amend its Access Arrangement Information to provide information separately for the following Covered Pipelines in Schedule A, Schedule 2 of the Code:
>
> (a) Wilton to Newcastle;
> (b) Wilton to Wollongong; and
> (c) NSW distribution system including the Central West distribution system.
>
> 1.2 Subject to 1-3, AGLGN must present the Access Arrangement Information in a format consistent with Attachment A of the Code, including the six categories of information and the specific items of information listed under each category.
>
> 1.3 Information regarding- operations and maintenance costs under category 3 of Attachment A of the Code may be aggregated by AGLGN as follows:
>
> (a) labour costs
> (b) non labour costs comprising cost of services by others including rental equipment, materials & supply and property taxes.
>
> Amendment 2 - Separation of transmission pipelines (chapter 3)
>
> In its Access Arrangement, AGLGN must establish and list Reference Services and Reference Tariffs for each of the Covered Pipelines
>
> (a) Wilton to Newcastle; and
> (b) Wilton to Wollongong,
>
> separately from the Reference Services and Reference Tariffs that it must establish and list for its NSW distribution system including the Central West distribution system."

Users however, were given some assurance that in approving AGLGN's revised AA and AAI in September 2000, the Tribunal stated that it:

> "……has assessed AGLGN's revised AAI to ensure that it meets the required amendments and that the updated tables and information incorporate the changes required as specified in the final decision.
>
> AGLGN has presented information for the following covered pipelines:
> - Wilton to Newcastle
> - Wilton to Wollongong and
> - NSW distribution system including the Central West distribution system.
>
> AGLGN has also amended its AAI to incorporate the six categories of information listed in Attachment A of the Code. Whilst the Tribunal has accepted some aggregation of operations and maintenance costs, this should not be seen as a precedent for future disclosure of information in the AAI. At the next review, assessment of the AAI will be made under sections 2.6 and 2.7 of the Code."

It is worth noting that even at this late stage, disclosure of information in terms of the Code provisions was not met by the access applicant and the matter would only be taken up at the next review period.

6. Audit of AGLGN's Pricing And Cost Allocation Model

In approving the revised AA and AAI in September 2000, the Tribunal said:

> "In its final decision, the Tribunal decided that it would appoint a consultant to audit AGLGN's pricing and cost allocation model prior to approval of the revised Access Arrangement. The purpose of the audit was to ensure that AGLGN's revised pricing and cost allocation model is consistent with the final decision, e.g. to ensure that reference tariffs multiplied by demand equal allowed revenue.
>
> After the release of the final decision, AGLGN agreed to provide its pricing and cost allocation model to the Tribunal's appointed consultant (KPMG) for auditing- purposes prior to its submission of its revised Access Arrangement. The audit was conducted by KPMG in August 2000. In early September 2000, KPMG submitted its audit report to the Tribunal which, within its terms of

> reference, found that AGLGN's pricing and cost allocation model is consistent with the final decision.
>
> AGLGN also advised the Tribunal that it has engaged a consultant to review its pricing model for the NSW gas network. A copy of its consultant report was provided to the Tribunal.
>
> The Tribunal has also undertaken its own review of AGLGN's pricing and cost allocation model**.**
>
> The Tribunal has considered the audit report and the outcomes of its own review. The Tribunal has reached an independent view that AGLGN's final pricing and cost allocation model complies with the final decision."

There appears to be some timing discrepancy here: an audit report was conducted by KPMG in August 2000, yet, according to published IPART documents, AGLGN did not submit its revised AA and AAI until 7 September 2000. It is also noted that "KPMG submitted its audit report to the Tribunal, which within its terms of reference, found that AGLGN's pricing and cost allocation model is consistent with the final decision."(page 2). No documentation relating to the terms of reference, the consultant's report, and the Tribunal's review seems to be available for public scrutiny. Again, users have good cause for concerns over the lack of transparency.

7. Transitional Revenues

The Tribunal's Draft Decision allowed AGLGN transitional revenues of $22m for 1999/2000 and $21m for 2000/01. However, in view of the extended access review, the Tribunal's Final Decision allowed for $12m. Nevertheless, the issue of awarding AGLGN a transitional revenue was highly contentious and remains so.

The transitional revenue component was gazetted on 14 April 1997 under section 2.12 of the NSW Access Code (during the course of the 1996/97 access regime):-

> "Section 2.12 of the NSW Access Code calls for a balance of the interests of a diverse range of parties:
>
> 2.12 In assessing a proposed Access Undertaking, the Regulator must take the following into account:
> (i) the owner's legitimate business interests and investment in the facility ...
> (ii) the interests of all persons holding contracts for use of the facility

> (iii) firm and binding contractual obligations of the owner or other persons (or both) already using the facility …
>
> The Tribunal considers that all these interests must be balanced. The balancing of these interests is a matter for the Tribunal's judgement, as regulator.
>
> It is important for users to keep in mind that the Tribunal must consider the Service Provider's legitimate business interests in its Determination. As discussed above, large reductions in revenues without an accompanying transitional program would not be consistent with this requirement.
>
> Tribunal considers that tariff market customers should be included in the category of persons holding contracts for use of the facility". The Tribunal considers that, to the extent that the rebalancing of tariffs may require tariff market revenue increases, tariff market customers should be protected from excessive rate shock. The Tribunal notes that tariff market revenue increases could be constrained by competition from electricity, particularly at the domestic level."

At the same time, the Tribunal said that:

> "Clearly there is substantial over-recovery of contract market costs at present. …… Analysis by the Tribunal and independent consultants to the Tribunal suggest that no substantial monopoly rents are being earned by the network as a whole. Hence, the over-recovery in the contract market appears to largely comprise a cross-subsidy [to the tariff market]." (page xvi Final Determination, July 1997)."

In 1999, AGLGN's draft proposed AA however, stated that there was no cross-subsidy to the tariff market. Yet the Tribunal saw fit to extend the transitional revenue component until 2000/01, but provided no reasons other than that it had "updated its financial modelling to assess the financial impact of alternative transitional component scenarios on AGLGN." (page 146).

8. Capital Contributions

Users' capital contributions have been a highly contentions issue since 1996, but the Tribunal, yet again, failed in its treatment of the issue in the 1999/2000 review. This is despite the fact that in its 1997 Final Decision it said that in the 1999/2000 review: "Assets funded from user contributions will not be included in the Capital Base for regulatory purposes."

In the July 1997 Determination, IPART dismissed the call by parties for recognition of past capital contributions by users in the setting of the Initial Capital Base. IPART commented as follows (page 7l):

> "The Tribunal is not seeking to compensate customers for higher prices paid per unit in the past. Nor is it seeking to compensate customers for making additional payments, that may have been labelled capital contributions. Therefore, the Tribunal has not taken capital contributions into account in determining reference tariffs.
>
> It is not possible for the Tribunal to reflect capital contributions in this manner in its Determination of an Access Undertaking. .... A tariff which reflected a particular customer's contribution would not be available to "a significant part of the market", and therefore could not be classed as a Reference Tariff. As the Tribunal's Determination relates to an Access Undertaking and the related Reference Tariffs, it is not possible to reflect the circumstances of particular customers which have made capital contributions.
>
> Accordingly, the Tribunal believes it would not be appropriate to reflect past customer contributions by reducing the Service Provider's capital base, or by adjusting the Reference Tariff."

(Although),

> "in future assets funded from user contributions will not be included in the Capital Base for regulatory purposes."

Section 8.8 of the NSW Code states that in determining the Initial Capital Base, regard must be had to a range of factors, including past users' contributions. Whilst the National Code does not specifically identify past capital contributions in the context of establishing the Initial Capital Base, it does, consider the issue under a separate section (6.20):-

> "If a User or Prospective User claims it has funded the construction of all or part of a Covered Pipeline, either directly or by agreeing to pay the Service Provider a higher charge than it would have paid in the absence of such a capital contribution, then in making a decision the Arbitrator must:
>
> (a) consider whether the User or Prospective User did make a capital contribution to the construction of all or part of the Covered Pipeline; and
> (b) consider the extent to which the User or Prospective User has recouped any such capital contribution.

> If the Arbitrator considers that the User or Prospective User has made a capital contribution which has not been fully recouped, the Arbitrator's decision under section 6.7 or section 6.13 may require the Service Provider to provide the Service at a Tariff set in a way that allows the User or Prospective User to recoup some or all of the unrecouped portion of the capital contribution."

As Section 6.20 of the National Code clearly identifies that past capital contributions should be taken into account by an Arbitrator, then it would seem somewhat incongruous that IPART ignored the issue.

The Tribunal said in its Final Decision:-

> "The Tribunal notes that past capital contributions were part of commercial agreements between the relevant party and AGL(GN). The Tribunal does not agree that it should revisit these agreements.
>
> The Tribunal has also considered the interests of users who made past contributions, as well as users generally. It is impractical from the point of view of users generally to include mechanisms in the Access Arrangement to deal with the past contributions of some individual users.
>
> The Tribunal has therefore decided not to allow for past capital contributions in setting reference tariffs. This decision does not imply that AGLGN received no benefits from past capital contributions or that AGLGN should earn a rate of return on assets it did not fund. Arbitration is available to users who believe their tariffs should be adjusted.

Future capital contributions

> The Tribunal has considered the treatment of future capital contributions. Sections 8.23 and 8.24 of the Code deal with capital contributions.
>
> As these sections imply, AGLGN should be free to negotiate capital contributions. These payments are important where a project otherwise might be uneconomic. Also, capital contributions provide a boost to short term cashflows.
>
> However, the current review has highlighted some concerns in regard to AGLGN's record keeping that the Tribunal considers should be addressed. The Tribunal will require AGLGN to maintain a database on all capital contributions it receives. The database should contain such information as the user's name, the level of capital contribution payments and the timing of payments."

However, it is recalled that in the Tribunal's Draft decision, it stated that: "If users are dissatisfied with their tariffs especially with regard to the treatment of past capital contributions, arbitration is available." (page 248). It is also worth pointing out that the non-availability of records (apparently claimed by AGLGN and accepted by the Tribunal) is somewhat misleading. During the 1999/2000 access review, several major users had offered to make their records relating to capital contributions available for scrutiny by the Tribunal. The offers were never taken up.

Users clearly have been agitated by the Tribunal's handling of the issue and it was an open secret that at least 2 or 3 companies were seeking to appeal the Tribunal's intended non-handling of the issue. The difficulty, of course, was that Section 6 of the Code would seem to suggest that arbitration is only available to a prospective user rather than an existing user, which in effect prevents all users who have made capital contributions (so much for the Tribunal's advice regarding arbitration). The only other avenue would be to take the Administrative Appeals Review route but given the extended delays in the access review, the complexities of the issues and the extensive documentation involved, the cost for individual users in taking this route would have been prohibitive.

9 Asset Valuation

The Initial Capital Base and hence the asset valuation methodology used to arrive at it, has a significant impact on the regulated revenue cap. Thus, from the network service provider's point of view, the higher the asset valuation, the greater the permissible revenue. However, experience has shown the network service provider's preference for the use of the DORC valuation, in that the method produces the highest feasible values, and creates a significant information asymmetry in favour of the network owner. As information asymmetry is one of the biggest problems for the regulator (and interested parties) this cedes a significant benefit to the network owner, which it hopes can be translated into rents.

The Tribunal in fact "notes the considerable range in estimates of the DORC value of AGLGN's assets" – and suggests that it "is indicative of the uncertainties of the approach." (page 76, Final Decision). The wide variation in asset values for AGLGN is illustrated in Box 4 below, and indicates that the number of possible asset valuations is limited only by the number of processes and assumptions adopted. The interests of the parties' commissioning the asset valuation studies are also illuminating.

Box 4

Variability Of ORC And DORC – AGLGN

Date	*Author*	*ORC*	*DORC*	*Comments*
1996	*J P Kenny*	*$2.44bn*	*$1.45bn*	*Audit of AGLGN methodology*
1999	*AGL*	*$2.56bn*	*$2.01bn*	*Based on JP Kenny*
1999	*Ewbank Preece*	*$1.8bn*		*Incumbent*
		$3.1bn		*New Entrant*
1999	*Kinhill*	*$3.1bn*		*Study for AGLGN*
2000	*GCI-Kenny*	*$2.3bn*	*$1.6bn*	*Study for BHP-new entrant*

The Number of Possible Asset Valuations Is Limited Only By The Number of Processes and Assumptions Adopted.

Source: Bob Lim. Presented At ACCC Public Forum On Asset Valuation, Melbourne. 16 June 2000.

Nevertheless, despite acknowledged shortcomings, the Tribunal "concludes that there is insufficient evidence to move from the estimate of DORC of $2,009m proposed by AGLGN in the Access Arrangement and used in the draft decision. This estimate has been used to establish the ICB and allocate the ICB to groups of assets." (page 76 Final Decision). It is important here to note that the National Gas Code requires the regulator to consider an upper bound asset value (represented by DORC) and a lower bound asset value (represented by DAC). Moreover, the Tribunal's Final Decision allocates a DORC value to the ICB for the high pressure system (which primarily services the contract market) but less than a DORC value for the low and medium pressure system (which primarily serves the tariff market). This is an issue concerning consistency of principles adopted by the regulator.

It is also worthwhile to note what the Tribunal said in regard to the ICB in its July 1997 Final Decision:-

> "The Tribunal will reassess the Initial Capital Base at the First Access Review. At that time, uncertainties in the marketplace should have dissipated. The Tribunal should therefore be better able to assess the reasonableness of the revenue stream. At that time, information should be available which allows the Tribunal to cross check the asset valuation based on the sustainable revenue stream against other benchmarks of asset values. Clear signals should be available from the tariff market which will allow the Tribunal to assess the reasonableness of asset values relating to high pressure and medium/low pressure systems.

> Pending the next review, the Tribunal has decided not to substantially modify the asset value proposed in September 1996. This decision does not signify the Tribunal's endorsement of that value. Rather, it reflects awareness of the uncertainties and information problems surrounding this and other estimates of the asset values at this time, and the fact that the Initial Capital Base does not affect prices in this initial Determination.
>
> Tribunal now considers that the revenue stream utilised in the September 1996 present value analysis overstated the sustainable revenue stream on three counts. First, the network revenues in that analysis included retail costs and margins. Second, the present value analysis included revenues collected during the transitional period (see the darker shaded declining wedge portion in the discussion box in section 3.3.3). Third, the September 1996 analysis did not adequately reflect the potential for cost savings in the network, as identified in the Greenwood Challoner report.
>
> The Tribunal considers that there is insufficient information available at this to adequately determine a sustainable revenue stream for the contract and tariff markets, and therefore signals its intention to revisit the calculation of the Initial Capital Base at the First Access Review."

Despite such reservations, AGLGN's 1999 AA proposed an even higher ICB of $1,733m (funds employed as at 1 July 1996). Subsequently, during the course of the 1999 access review AGLGN continued to push up its ICB!

Clearly, there is a need for an accepted set of regulatory principles and assumptions concerning asset value methodologies and the assessment of the ICB.

10 Corporate Restructuring

It is a point of fact that organisations do undergo organisational changes and restructuring over time and that AGL in particular has been prominent in this area. The major organisational changes (as reported by NERA in their report, **Seeking Gas Competition In NSW**) are shown in the following chart:-

Figure 2: Organizational Changes, FY 1995-FY 1998

	AGL Gas Companies			**AGL Pipelines**
94/95	**D**	**t**	**G c**	**T**
	AGL Gas Companies			**AGL Pipelines**
95/96	**D**	**t**	**G c**	**T**
	Energy Utilities			**Energy Trading & Transmission (ET&T)**
96/97	**D**	**t**	**G c**	**T**
	Energy Infrastructure			**Energy Sales & Marketing.**
97/98	**D**	**T**		**t** **G c**

Note: D: Distribution, T: Transportation; G: Gas Sales; t: tariff market; c: contract market. Dashed lines indicate that there is no accounting separation in publicly available documents while solid lines indicate the existence of separation in documents.

Source: **Annual Reports and Offering, Circular.**

Since then, AGL has undergone further organisational changes. The point that is being emphasised here is that, in the absence of sufficient information, it is difficult for regulators or interested parties to properly identify the source of AGL's profits, costs, and cost allocations, and to verify regulated and unregulated business operations.

AGL's placement of its gas pipeline assets in a new listed company, Australian Pipelines Trust, with services being provided to this company from an AGL subsidiary (Infrastructure Management and Services) raises very important questions, especially as there is potential to adversely affect competition, both upstream and downstream, and the effectiveness of economic regulation under the Code. For example, it is unlikely that the infrastructure management services company will be subject to the Gas Code and hence, to the provision, such as ringfencing. However, it will have all of the information on the network operations, including on the activities of competing retailers. If this information is made available to AGL's retailing business the retailing business would have an unassailable competitive advantage.

It is likely that the asset owning company would be subject to the Code, and hence operating costs and new capital expenditure would be subject to regulatory scrutiny under the Code. However, if these services are purchased under an agreement from the infrastructure management company, they may include an additional profit component and not be subject to disclosure and regulatory review. Indeed, some analysts such as Merrill Lynch have stated that one of the most important aspect of the current restructure is the opportunity for AGL to capture excess returns and pass them to shareholders, rather than passing them to customers at the request of the regulator.

The above suggests that regulators and regulatory Codes need to take cognisance of organisational charges that could have the effect of reducing competition and/or masking cost and profits between regulated and unregulated business operations of vertically integrated organisation such as AGL. History shows that timely information disclosures are critical to ensure effective economic regulation in NSW. It is clear that the National Gas Code needs major amendments – especially in the light of the organisational changes such as those involving AGL – to enable adequate and timely information disclosures and transparency and scrutiny of related party transactions.

11 Concluding Comments

The experience with the N.S.W. access reviews in 1996/97 and 1999/2000 clearly shows the difficulties in obtaining access to network facilities on reasonable terms and conditions and in a timely fashion. Regulated companies are responsible to shareholders and are unlikely to take actions which are perceived as against their interests. This is especially the case with vertically integrated businesses. They are well-resourced and equipped to test legal interpretations of Code provisions.

The 'cat and mouse' regulation experience in NSW shows how third party access can be denied or delayed with the resultant costs. Yet there did not appear to be any Federal or State institution (during an access review) able to address the difficulties, particularly with respect to competition issues and practices. The consequences have been essentially a 22 months access review in 1999/2000 (with the implications for costs and competition in downstream markets) and a $28 million gas pipeline duplication (notwithstanding efforts at negotiating access).

There are clearly aspects of the Code which either need clarification or strengthening, and the chairman of the NSW Independent Pricing and Regulatory Tribunal said as much in his foreword to the Tribunal's final report on the AGLGN access application. We suspect that this has much to do with legal challenges to IPART's powers under the Code, which may have constrained the Tribunal in its regulatory tasks.

A 'light' approach to regulating network facilities, which are part of a vertically-integrated business (and that undertakes frequent corporate restructuring) will mean (as has been shown) that consumers and potential competitors will be disadvantaged.

In a report prepared for BHP Petroleum, 'Initial comments On AGL's Revised Access Arrangement' (22 March 1999) NERA (which has evaluated gas access arrangements world-wide) made the following comments in relation to the National Gas Code:-

"The Code is comparatively new, and its language is general. Nevertheless, the basic prescriptions of the Code are entirely consistent with time-tested regulatory practices elsewhere. It covers the essential points regarding the protection of AGL's property, the protection of the public interest and the promotion of gas supply competition over regulated pipeline infrastructures like AGL'S. The Code thus provides a solid basis from which IPART can evaluate AGL's filing.

As such, the Code provides the basis for ensuring against the types of abuses about which regulators generally must be mindful. Of particular importance regarding AGL's submission, IPART must deal with the following issues:

1. AGL has come up short in its responsibilities to inform IPART, its current (and potential) customers and its competitors.
2. AGL has not made the verifiable separations in the costs of its diversified enterprises that would allow IPART or other parties to be reasonably sure that captive customers are not cross-subsidizing AGL's unregulated activities. The Code's ring fencing provisions are not sufficient to prevent abuses in this respect, as shown by the more careful cost separation practices of other gas company regulators around the world.
3. AGL appears to have performed cost allocations among customers in a fashion that raises competition and access concerns."

Experience with the 'cat and mouse' regulation, which basically characterised the review process in 1999/2000, however, suggest certain improvements that could and should be made to the National Gas Code and to regulatory practices:-

1) Regulatory charts of accounts establishing minimum data and information consistent with Attachment A of the National Gas Code (Information Disclosure By A Service Provider To Interested Parties) should be established by regulators and required to be submitted by the access arrangement applicant (in accordance with the regulators' directions) in its AA and AAI (in other words information disclosure should not be provided on a piece-meal basis, nor open to regulatory gaming practices).
2) Claims of confidentiality e.g. in relation to related party transactions, must be resolved by regulators after public consultation within a month of the submission of the AA and AAI.
3) Overt regulatory gaming abuses and practices, such as frequent changes in pricing structures and delaying practices associated with information disclosures, should not be sanctioned.
4) All disclosures of data and information must be sanctioned by auditors and directors as to their veracity.

5) The period between the lodgement of an AA and AAI and the regulator's final approval must not exceed nine months.
6) Asymmetry (in terms of information and resourcing) between the service provider on the one hand, and the regulator and users on the other, must be minimised. For instance, users' advocacy costs should be funded out of regulatory revenue (in the same way as the service provider's regulatory costs) and regulators must be adequately resourced.
7) The skills and resource base of regulatory agencies need careful consideration. There is a solid case for establishing a properly resourced national energy regulator.
8) Users' rights under the Code need to be improved, especially in relation to appeals to the Australian Competition Tribunal, Administrative appeals and recourse to an arbitrator.
9) Regulatory treatment of the ICB must be undertaken under strict principles and assumptions, and the issues of asset lives and optimisation practices require regulatory standards to be established and adopted.
10) Incentive-based economic regulation, represented by price or revenue caps, should be supported by an established set of regulatory pricing principles, in particular to prevent predatory pricing, discounting and reloading.
11) Regulatory performance should be subject to some form of accountability, for example by establishing a low cost and speedy process for complaints to be lodged and arbitrated during a review. Types of issues could include regulatory consistency, failure to deliver on earlier regulatory decisions, failure to deal with code requirements, lack of transparency in regulatory actions, and so on.

Attachment A

RESPONSE TO IPART ON NEW SOUTH WALES DISTRIBUTION ACCESS DRAFT DETERMINATION MAY 1997 BUSINESS COUNCIL OF AUSTRALIA

1. Introduction

The Business Council of Australia appreciates the opportunity to comment on IPART's Draft Determination on access to the NSW gas distribution system. The Council appreciates the dedication and effort that have gone into arriving at this Draft Determination over the last six months and is particularly appreciative of IPART's willingness to closely consult with gas users and user groups.

2. Concerns with Draft Determination

Although the amendments made to the September version of the Access Undertaking are generally supported, the Business Council retains a view that the current Access Undertaking and the Draft Determination are based on principles and data with which the Business Council is in substantial disagreement. All of these matters have been fully presented to IPART over the prior six months, and are restated here in summary only:

(i) the Asset Base for both high pressure and low pressure regimes are over valued and lack credibility.

(ii) The transition arrangements are uncertain and too generous.

(iii) The Rate of Return is inappropriately high.

(iv) The method for Cost Allocation is discriminatory and provides for uncertainty.

(v) The Ring Fencing arrangements have not had an adequate review and there are concerns with the delay and their adequacy.

(vi) Capital contributions by users have been inappropriately discounted.

(vii) The Tradeable Capacity Surcharge is unrelated to the cost of providing the service and seems to be anti-competitive.

The Business Council believes that both IPART and users have been disadvantaged by the absence of appropriate financial and operational data.

3. Next Review Cycle

The difference in revenue between the Draft Determination and the Business Council's assessment is wide and we welcome IPART's indication that the Draft

Determination would not set any kind of precedent or benchmark which could inhibit or bind future Determinations.

The Council is, however, mindful of the difficulties in having to reach an agreement with the network service provider and of IPART's clear objective in providing Third Party Access for wellhead competition.

The Business Council will be prepared to support the Draft Determination and expedite Third Party Access to New South Wales gas distribution networks. However, the Business Council would be looking to IPART - and the NSW Government to the extent that it may involve changes to the regulatory regime - to outline sooner rather than later the process and milestones that might apply to the next review cycle. In particular, the Business Council would like to see IPART address the following matters in its final Determination:

(i) Confirmation as to the details of the regulatory chart of accounts that should apply to the network service provider (and other distributors) from 1997-1998 and disclosure of this information to the market.

(ii) Confirmation that some key variables used in the present Access Undertaking will not be taken as precedents for 1999. Those variables include the asset base, the weighted average cost of capital and the cost allocation approach.

(iii) Recognition that transition arrangements (including the contestability thresholds and the GCRA) are already generous and that any request for extension beyond 1999 must be made by the network service provider before the end of 1998 (or at very least after the Tariff Market Review), by way of a written proposal (authored by the network service provider) that is then made the subject of full and open public review and comment.

(iv) Recognition that there has been ongoing controversy as to the Greenwood Challoner methodology for the pricing of transportation services to the Contract Market. The Business Council would hope that IPART can deal with this matter before the fourth quarter of calendar 1998, perhaps initially by the release of an issues or options paper. The formal review process (of the updated Access Undertaking) should proceed more smoothly if the cost allocation methodology to be used is made clear and transparent before the updated document is submitted.

(v) Confirmation of the other detailed activities, timelines and milestones for the review process. It might be appropriate, for example, for IPART to require that the process include an early release (September 1998) by the network service provider of the following categories of information:

- Financial accounts for the year ended June 1998, including the previously agreed regulatory chart of accounts.
- The proposal, if any, on the future of transition arrangements.
- The network Service provider's estimates of the cost of allocations that result from the IPART pre-approved methodology.

(vi) It is also recommended that there be a separate hearing on the issue of how prior capital contributions are to be accounted for in setting individual site-specific charges. We would suggest that this take place before the fourth quarter of calendar 1998.

(vii) Finally, clarification that the ring fencing requirements of the NSW Access Code are to be mandatory and not voluntary.

It would be particularly beneficial if a positive IPART view on these issues could be incorporated in the final Determination to provide a guide to the 1999 Review.

Business Council of Australia
12 June 1997