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The National Access Regime Inquiry
Productivity Commission
PO Box 80
BELCONNEN ACT 2616

Dear Sir

This letter constitutes Santos' submission to the Productivity Commission's Review of Clause 6 of the Competition Policy Agreement and Part IIIA of the Trade Practices Act.

IMPACT ON INVEST

Santos' view is that compulsory third party access arrangements as embodied in Part IIIA and in specific industry access codes can and do have significant impacts on the commercial operation of existing investment and on future investment. This issue was acknowledged in the Hilmer and in recommending the creation of a generic third party access arrangement the Hilmer Report also recommended that this issue should be given due regard.

The problem with the claim that compulsory third party access regimes have a negative impact on new investment is that it is difficult to establish the argument quantitatively. This does not make the argument invalid however. Indeed the argument for Part IIIA and for industry specific third party access codes has been conspicuous in its absence of quantitative support. In a number of industries to which compulsory third party access arrangements have been applied or contemplated, there has been little evidence of behaviour which has sought to deny access for anti-competitive (or indeed other reasons).

There are a number of examples which indicate a weight of anecdotal evidence which is contradictory to the need for third party access: a survey of petroleum (exploration and production) permit holders conducted by the Gas Reform Task Force, produced little evidence of behaviour which, in the eyes of third parties, constituted deliberate denial of access; in the case of the Eastern Gas Pipeline (EGP), a proposed pipeline from Victoria to Tasmania and a proposed pipeline from Darwin to Moomba (DMP), the proponents have claimed that the rules of the existing National Third Party Access Code for Natural Gas Pipeline Systems (NAC) inhibit their willingness to invest in the projects.

If the justification for third party access is the theoretical argument that a facility owner will seek to use any inherent monopoly power to extract rent, then the reduction or removal of this opportunity reduces the incentive for investment. This is not an argument that third party access eliminates the incentive nor is it an argument to say that the issues which may justify access are invalid. It is difficult however to argue that something which reduces an investor's returns is not something of a disincentive to invest.

GENERIC CODE

The indeterminacy of the impact on investment indicates that Part IIIA and industry specific codes need to be cautiously applied.

In this context Santos is of the view that compulsory third party access should only apply through a generic code such as Part IIIA. If industry specific provisions are required then these should be provided by way of a code or regulations which are subsidiary to Part IIIA but which reflect a universal set of principles.

EX-POST COVERAGE

The guiding principles of a generic code such as Part IIIA should be to establish:

1. Proof that commercial negotiation has occurred and failed.
2. An obligation on the applicant through the decision making body to establish that application of Part IIIA (the coverage issue) is appropriate according to the definitions and conditions of Part IIIA (as modified).

This essentially changes the current process by which a third party notifies an 'access dispute' (S4LS[1]) for an already declared service. This proposal requires the notification of an access dispute (and proof) prior to the declaration of a service (Division 2, Subdivision A and Subdivision B).

The purpose of this is to ensure that third party access rules are only applied for compulsory access as a consequence of a legitimate attempt to achieve a negotiated commercial arrangement.

This is superior to arrangements whereby a complete industry is required to be 'declared' or 'covered' regardless of any actual requirement for access by a third party. This superiority arises from the significantly reduced costs to facility owners to meet what may be unnecessary costs in relation to meeting the obligation of the Reference Tariff and in Ring Fencing.

The overall relevance of this proposal to establish an initial obligation for bona fide commercial negotiation prior to an application for declaration or coverage can be shown by reference to the debate over the proposed Access Undertaking (under Division 6 of Part IIIA of the Trade Practices Act) as sought by the proponents of the EGP and the parallel action by AGL to both have EGP declared covered under the NAC and / or the revocation of Coverage of EAPL under the NAC, both to be considered by the WCC.

Ignoring the issue of the two regulators effectively considering the same question (albeit under slightly different rules) and the early but eventually unfulfilled promise by the ACCC and the NCC to work together on these matters, there is another important issue.

This is revealed by the NCC's response to criticism. The Chairman of WCC made two statements which Santos believes go towards supporting the proposal above.

The first of these statements was that '... thus there is a formal process to consider whether particular pipelines are indeed monopolies and therefore subject to regulation'.

Given this reference included EAPL, this was simply untrue. EAPL, like most pipelines existing at the time of the enactment of the NAC did not go through a coverage test. The Coverage provisions embodied in Clauses XX to YY of the NAC were not applied in a conscious, public and transparent manner. EAPL and other pipelines were covered by the NAC by means of an administrative convenience. A large number of pipelines were simply included in a schedule (Schedule A) without the formal application of the Coverage provisions of the NAC.

Of itself this may not seem to have serious implications, particularly as the owner / operators appeared not to object. However once the gaming associated with the EGP proposal to effectively avoid Coverage under the NAC (adjudicated by the NCC) by achieving an Access Undertaking under Part IIIA (adjudicated by the ACCC), the use of this administrative convenience became significant.

Effectively EAPL was forced to seek to establish a case for the Revocation of Coverage under the same rules as EGP was seeking to refute a case for Coverage.

If you accept the 'Coverage / Revocation' provisions are neutral then this is a non issue. However to the extent any argument is offered that the Coverage provisions are too onerous to achieve 'proper' Coverage by definition they are too onerous to allow 'proper' revocation.

This may be an extended argument but it indicates the extent of unforeseen situations which arise from ex-ante Coverage rather than ex-post.

The fact that the Chairman of the NCC would be unaware of Schedule A in defending the actions of the NCC is of concern.

The second statement was made to establish the efficacy of the NAC, with the Chairman saying:

> '... have stressed the importance of sound regulation of gas distribution pipelines to the viability of new transmission pipelines'.

While this may establish a case for the NAC applying to the distribution systems it hardly establishes a case for coverage of transmission pipelines, yet these were covered by the use of Schedule A.

Both comments by the NCC are indicative of the problems which arise when Coverage is exante.

COVERAGE TEST

There is reason for concern about the way the NCC has chosen to interpret the 'duplication' test (S44 G[2][b]).

Essentially the NCC has interpreted this test to be a 'social test' rather than a 'private test'. The difference is put that the 'social test' measures the associated costs and benefits of development for a society as a whole whereas the 'private test' relies on a narrow accounting view of 'uneconomic or profitability' of the individual.

This interpretation relies on the views expressed by the Australian Competition Tribunal (ACT) in relation to the Sydney Airports decision.

Santos contends that the preference for the social test is wrong.

It is worth considering that if the intent of the Competition Policy Reform Act was to implement intervention in the economy to avoid duplication, Part IIIA appears to be a strange route to choose.

Firstly not all uneconomic duplication is targeted. The definitions (S44 B) explicitly exclude a very large part of the economy. Secondly, the criteria (S44 G[2][b]) is only triggered if an application is made (S44 F[1]). These appear to be unusual limitations if the intent was to seek the benefit of 'society as a whole'.

Further, the inclusion of S44 G(2)b would be unnecessary if its goal was the public interest. The public interest (which can be equated with the '... costs and benefits of development for society as a whole') is assessed by S44 G(2)(f).

Section 44G(2)(b) can only serve a separate purpose if it is meant to do something other than to serve or protect the public interest. S44 G(2)(b) serves another purpose and that is to give to the facility owner a protection against parties seeking access on a basis of just seeing if they can achieve a better outcome than a viable stand alone facility. If the question is that of scope raised in the ACT Sydney Airport decision, then amendment to the word 'anyone' may be required although limiting the criteria just to the access seeker may be dangerous.

The real issue is not however to debate interpretation but to ensure that the purpose of S44 G(2)(b) is clarified.

PRODUCTION PROCESS

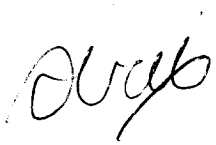
Santos supports the existing definition of 'service' (S44B).

Part IIIA lacks an appreciation that facilities are often part of complex production processes and that the usage of facilities or parts of facilities will often be adjusted to meet contractual obligations.

Any relaxation of the service definition is likely to impinge on a wide range of activities and facilities operating in the production and processing sections. Particularly it is likely to effect: oil refining, mineral processing, chemical processing and may extend to all production processes including manufacturing plants. It is not an argument to say that significance is a test which would provide protection. State regimes and regulators seriously diminish the meaning that significance may have in a national context. Further, the stated intention of some states to use access for 'state development' rather than 'competition' reasons will also influence this outcome.

Apart from the 'service' definition, this issue is only reflected in S44W which places restrictions on access determinations. Unfortunately S44 W(1)(a) focuses on the quantum of service rather than allowing flexibility in the production process. Further, the restriction is limited by identifying the existing users need as being the 'sufficient amount to meet the users reasonably anticipated requirements measured at the time when the dispute was notified'. Again this has the potential to limit production flexibility.

Yours sincerely



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