Submission to the Productivity Commission on the:

Draft Report into the Review of the Gas Access Regime

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Executive Summary

The companies strongly endorse the Draft Report and welcome the Productivity Commission's (hereafter the Commission) proposals to improve the National Gas Code in terms of encouraging dynamic efficiency, providing stronger appeal provisions to protect private property, and including provision for price monitoring to reduce the costs of regulation.

The companies would like to make some suggestions to improve the regulatory model for gas as outlined by the Draft Report and in particular to take into account some of the recent legal decisions that impact on the Code that were made after the Draft Report was released.

The Commission's proposals for price monitoring could be improved by:

- Moving all utilities to a price monitoring regime rather than requiring the National Competition Commission (NCC) to assess, for each company, the case for the application of lighter handed regulation. This suggestion is made in light of the fact that all utilities have been subject to at least one cost of service price review so their costs and prices will, by definition, be efficient. On this basis, any further assessment by the NCC of the case for lighter handed regulation would be redundant

- Developing guidelines for the NCC to assess decisions on coverage and lighter handed regulation to ensure that the model proposed by the Commission works effectively

- Subjecting revocation of coverage decisions to the same requirements as moving to light handed regulation, that is, rulings of revocation should, like the price-monitoring tier of coverage, remain in force for a period of five years before they can be challenged

- Clearly indicating the Commission's preference for the majority of gas distribution assets to be under the price monitoring option given the constraints on market power within which gas distributors operate

- Detailed guidelines for the operation of the price monitoring regime should be developed by the Commission rather than leaving this task to the NCC, and

- Key assessment criteria for the 5-year review should be developed by the Commission based on proposals set out in this paper.

In addition to these changes to price monitoring the Commission should also attempt to improve the basis of reference tariff approvals for Tier 1 companies given the need to ensure efficient investment in this sector. In particular there have been a number of recent court decisions which should be considered in the development of the new Code including that:

- A new section should be placed in the Gas Code (Reference Tariff Approval) dealing with how the CAPM model is to be used in determining reference tariffs in the context of a workably competitive market for utilities under the reference tariff approval model

- In approving reference tariffs, the relevant regulator should assess the distributor's proposals for conformance with the Code and if the Capital Asset Pricing Model (CAPM) variables are within a commercially acceptable range the regulator must approve the reference tariff levels. This would also be more in keeping with the concept of workable competition

- In approving reference tariffs via the CAPM model that the relevant bond rate to use is one consistent with the life of the asset and the longest dated domestic bond

- Cost effective and efficient insurance is permitted by the National Gas Code and that costs associated with counterparty default and terrorism should be pass throughs in reference tariff decision for utilities under the reference tariff approval model

- Procurement of the lowest cost equipment by a distributor is not a requirement under the Gas Code and that there are numerous reasons why the lowest cost for equipment should not be used for example in term of quality, delivery capability and timeliness;

- The recent Australian Competition Tribunal (ACT) decisions that relate to the interpretation of the current Code be reflected in the new National Gas Code; and

- Given the appeal decisions relating to the interpretation of Section 2.24 (a) in terms of protecting the property rights of utilities that Section 2.24 (a) should be retained as a Code objective.

There are a number of other suggestions that the Commission has requested comments on and these include that:

- Regulators should not have the power to review asset management contracts between distributors and their asset management business because of the original requirements of the code and the business drivers to operate asset management businesses in an efficient and effective manner.

- A service provider entering an associate contract for the supply of services at the reference tariff must notify the relevant regulator, but is not required to seek authorisation, and the

- New Gas Code should allow all the actual costs of regulation by the regulator to be recovered from consumers.

The companies believe that with these changes the Code will be more in keeping with encouraging dynamic investment and ensuring that consumer benefit will be maximised over the long-term through the provision of effective and efficient gas infrastructure.

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1. Introduction

This submission on the Draft Report of the Productivity Commission's (hereafter the Commission) Review of the Gas Access Regime is from Multinet Gas (Vic.) and Alinta (WA) ('the companies' hereafter). Multinet Gas is an urban distributor servicing some 626,000 gas connections in Melbourne's Eastern suburbs and Alinta is a gas distributor and retailer which serves more than 440,000 gas customers in Western Australia. The companies are part of the AMP-Henderson DUET Trust and are managed by Alinta Network Services.

The companies strongly endorse the Draft Report and welcome the Commission's proposals to improve the National Gas Code in terms of dynamic efficiency, appeals and to reduce the costs of regulation. The companies would like to make some suggestions to improve the regulatory model for gas as outlined by the Draft Report and in particular take into account some of the recent legal decisions made after the Draft Report was released.

In addition to the general conclusion that the National Gas Code in its current incarnation is deficient, the companies welcome the Commission's recommendations on the appeal arrangements for gas pipelines as providing a necessary protection for private property rights and for keeping regulatory decisions consistent with the intent of the Code. In light of the movement to a national regulator and the relative lack of appeals under the Electricity Code the companies request the Commission to make a major statement of principle that strong merit appeal rights are essential for any best practice regulatory regime.

The areas that the companies would like to comment on include the:

- Operations of the Western Australian (WA) gas industry
- Movement between tier 1 and 2 pricing options
- Price monitoring options
- Reforms to the approval of reference tariffs
- Approval of associate contracts
- Administrative and appeal systems

2. West Australian Gas Industry

Figure 2.2 on page 8 of the Draft Report, while perfectly accurate, does not immediately show the proportion of gas reserves in Western Australia, which as the percentage figures show, are over 75% of the Australian total. A map which pictorially rather than numerically shows the proportion of gas in WA would give a more clear presentation of the gas supply situation.

Page 16 attributes the high share of gas in WA to limited coal reserves. In fact according to the WA Office of Energy[1], there is slightly more coal than gas in WA. The companies

1 Energy Western Australia, p 19

believe that the share of gas can be attributed to other factors such as cost competitiveness, the high moisture content of WA coal and environmental issues.

3. Movements between Tiers

The companies strongly support the Commission's recommendation that price monitoring of energy utilities should be introduced into the National Gas Code. Gas utilities are unable to exert strong market power due to the competition from other energy sources and from the changing structure of the industry. This consideration, coupled with the fact that most gas distributors have already been subjected to at least one independent cost-of-service review, suggest that a movement to price monitoring is appropriate.

A lighter-handed approach provides greater scope for utilities to price, invest and operate efficiently. Price monitoring enhances market transparency by allowing the community to scrutinise prices and market outcomes, and can also assist the competitive process, without resort to heavy-handed price controls.

While the companies strongly support the proposed movement to light handed regulation based on price monitoring we consider there are strong grounds to move all distributors to this form of regulation. These grounds include:

- All distributors were automatically "covered" by governments under Schedule A of the *Gas Access Pipelines Law* without any assessment of their market power or the costs and benefits of regulation
- The problems with the approval of reference tariffs as outlined by the Commission's Draft Report
- As already noted, most distributors have been through one and some have been through two highly intrusive cost of service price reviews thoroughly examining all costs. By definition therefore, these utilities' costs and prices should already be efficient; and
- An assessment of gas distributors in New Zealand (NZ) to determine whether they should be subject to reference tariff approval found that at current cost asset valuations the unregulated distributors did not exert their market power.

The approach of commencing the new regime with all utility assets covered under the price -monitoring tier would avoid the costs of the initial coverage decision - the automatic coverage of all pipeline and network assets in 1997 by virtue of Schedule A of the *Gas Pipeline Access Law*. As the Commission has noted, the evidence is that this was a costly public policy error, which led to the need for around 20 costly and lengthy revocation processes.[2]

In this context, it is noteworthy that the Ministry of Economic Development in New Zealand were concerned that unregulated gas transmission and distribution companies were earning more than they would under certain forms of price control, and that users would benefit from

2 Productivity Commission (December 2003), p.161

price controls. In 2001 they commissioned Covec to determine whether it was necessary or desirable for gas pipeline charges to be controlled.[3]

Covec undertook the analysis in two stages. First they examined the returns realised by the companies against the benchmark of a hypothetical competitive market where returns above the competitive level are taken as evidence of monopoly pricing. Secondly, in the event that monopoly pricing was found then the costs and benefits that would accrue to users if the industry were subjected to price regulation was estimated.

The Covec report found that:

> " the existence or otherwise of net benefits to acquirers from price control in these activities depends on the asset valuation concept that would be employed in setting those prices. If reported ODV is to be used there are no major benefits; if depreciated historic cost is used there are likely to be benefits in excess of $20m per annum."[4]

In Australia there is general acceptance of a current cost measure for asset valuation as it provides a better measure of replacement cost.[5] In Australia the Depreciated Optimised Replacement Cost (DORC) valuation is used whereas the above analysis used Optimised Deprival Value (ODV). The Covec report supports the proposition that gas distributors are constrained in terms of exerting market power by competition from other energy sources and by other constraints as outlined in the Commission's Draft Report.

Given this conclusion the fact that in Australia most regulated distributors have been through at least one cost of service price review their costs should be more efficient than NZ distributors. The Final Report by the Productivity Commission on the National Access Regime (p.346) found that past cost of service reviews were important in moving to a more light handed regulatory model:

> "In the Position Paper the Commission recognised the complexities of moving to productivity-based approaches and, in particular, the issue of how to establish starting cost-bases. However, it noted that as a result of past building block exercises, cost-bases have already been established for most essential infrastructure services in Australia. Thus, the Commission suggested that there would be significant benefits in taking advantage of this data and relying to a greater extent on productivity-based approaches to capping prices for access to that infrastructure."

Thus the facts that distributors have been though at least one price review and that most are therefore highly efficient supports the principle that all distributors should start on price monitoring.

In regard to the problems of the assessment of reference tariffs by the use of the CAPM model the Commission on page 233 of the Draft Report has argued that:

> "While the debt costs of a service provider are relatively straightforward to assess, the return required by equity investors is not. The return on equity is typically estimated using the capital asset pricing model (CAPM). This method depends on the measurement of two contentious variables — a service provider's 'beta' (a measure of its risk relative to that of the total market for risky investments) and the market risk premium (box 7.9).

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3 Covec, Natural Gas Pipeline Regulation. Is it Necessary or Desirable, July 2002? Available from www.covec.co.nz.

4 op cit. p.31. The analysis used actual industry costs in the estimation of monopoly pricing.

5 Henry Ergas, Valuation and Costing Issues in Access Pricing with Specific Applications to Telecommunications, in "ACCC and PURC Infrastructure Regulation and Market Reform: Principles and Practice", 1997, p.91

> Implementing the WACC/CAPM approach is not a precise science, given the numerous debatable assumptions involved. There is even disagreement on the precise formulas to use, due to different views on how issues such as tax should be treated. Hence, a range of plausible values can be generated for the regulatory rate of return using the WACC/CAPM approach. This in turn implies that meeting the Gas Code's requirements does not automatically lead to a single indisputable number for a reference tariff".

The problems with the use of this model also supports the proposition that all distributors should initially start on the price monitoring option.

Recommendation 1

That all distributors start on the price monitoring option for an initial five-year period after which an independent review will determine if they stay on price monitoring.

4. Options for Price Monitoring

The companies support the Commission's recommendation that the price monitoring would apply for an initial probationary period of five years without the ability of any one to reverse this decision. The companies also support the Commission's recommendation that an independent review would be conducted towards the end of this period to determine whether there have been unjustifiable price increases that warrant reimposition of price controls or whether price monitoring would continue. The threat of possible re-regulation will encourage negotiated pricing outcomes based on efficient costs and an adequate return on capital.

The companies also note that utilities under price monitoring will still be subject to the existing laws governing anti-competitive behavior and the abuse of market power during any period of price monitoring. This should be a further incentive against any anti-competitive behavior.

The companies also recommend that utility-specific price monitoring be consistent with any generic price monitoring provisions as a test of reasonableness.

The companies support the proposed two-tiered approach recommended by the Commission, but are concerned to ensure that there is not scope for inappropriate 'regulatory creep' to undermine the implementation of the Commission's model. The companies are concerned at this potential to occur under the Commission's model with assets potentially shifting multiple times through levels of coverage and different types of regulation. The companies are also concerned about the problems of interpretation of the terms "material" and "substantial" and consider that without detailed guidance of these matters, the regulatory approach proposed by the Commission will be less certain for the parties.

A final concern of the companies is that without explicit guidance there is a risk that the existing coverage body (the NCC) may recommend price monitoring apply to a smaller number of assets than the Commission is likely to consider appropriate given the NCC preference for previous regulatory options that were turned over by appeal or by Ministerial decisions.

To address these concerns, we consider that:

- it would be appropriate for the code to reflect a presumption that (for the reasons set out in the Commission's Draft Report, and noted throughout this submission) the universal

application of price monitoring is the most efficient form of regulation of companies that remain covered, and is therefore the "default" form of regulation to be applied to companies that remain covered; and

- subsequent assessments (undertaken by the NCC or any other body) of whether the application of price monitoring is to be continued should be based on a specified set of principles which place the onus on the assessor to demonstrate that movement to a more intrusive, prescriptive or "heavy handed" form of regulation is justified. To this end, it would be highly desirable for these principles to require the assessor to clearly demonstrate the benefits of moving a company from a price monitoring regime to a more intrusive regime, with reference to criteria that focus on economic efficiency and market conduct (i.e. anti-competitive behaviour).

Assuming that distributors would remain covered, it is suggested that the following principles could be incorporated into guidelines governing the application of the efficiency test:

- Price monitoring should apply to distributors that have in place appropriate structural or other arrangements that facilitate open access to their networks. As a general principle, a non-vertically integrated distributor would be assessed as having no incentive to refuse access on sound commercial terms – and hence would be assessed as meeting the requirements for the application of a price monitoring regime - unless it is demonstrated otherwise.

- As a general principle, any distributor that had been through at least one cost of service review would be assessed as having efficient costs – and hence would be assessed as meeting the requirements for the application of a price monitoring regime - unless it is demonstrated otherwise.

- As a general principle, if a distributor has limited capacity to exert its market power, it would be deemed to meet the requirements for the application of a price monitoring regime.

    - A distributor facing competition from a competing transmission line would, as a matter of general principle be considered to be constrained in its ability to exert market power, and hence would be deemed to meet the requirements for the application of a price monitoring regime.

    - A distributor serving a market where there are large users, or where it is in competition with an electricity business or where it sells relatively low average volumes, or where it is in a greenfield site would as a matter of general principle be considered to be constrained in its ability to exert market power.

The potential also remains under the Commission's proposals for circumstances to arise where assets covered under the 'reference tariff' tier of regulation successfully apply to have coverage completely removed (for example, due to the development of a competing pipeline).

However, it is open to any access seeker to seek coverage of the asset immediately following this decision, potentially creating significant uncertainty and costs for a service provider that has recently incurred substantial costs seeking revocation of coverage.[6] This

[6] See Productivity Commission (December 2003), p.256

situation could promote the unintended use of coverage applications as mechanisms for strategic behaviour for users. For these reasons, the companies consider that rulings of revocation should, like the price-monitoring tier of coverage, remain in force for a period of five years.

Recommendation 2

That the Commission clearly indicates its preference for the majority of gas assets to be under the price monitoring option given the market power constraints under which the owners of those assets operate.

Recommendation 3

That the Commission develop should detailed guidelines based on the above for the NCC to assess market power and efficiency in distribution businesses for coverage and level of regulation decisions. The guidelines should reflect a presumption that unless it is demonstrated to the contrary, the application of price monitoring to all covered companies is the most efficient form of regulation

Recommendation 4

That the Commission recommends that rulings for revocation stay in place for a minimum period of five years before they can be challenged.

4.1 The Price Monitoring Model

The Commission has recommended (8.2) that the price monitoring under the Gas regime should have the following features:

- A third party access policy formulated by the service provider
- Separation of pipeline operations from associated businesses in upstream and downstream markets
- Public disclosure of information by the service provider (which would be well short of the 'access arrangement information' currently required under the Gas Code)
- Scope for the service provider to adopt, at its discretion, additional pro-competitive features, such as a code of conduct.

The companies also support the Commission's recommendation (8.3, 8.4) that the NCC specify the requirements for information provision as part of a coverage decision to apply the price monitoring regime with the following terms:

- The regulator would focus on trend performance, including in relation to profitability
- The regulator would publish the information annually keeping any comment to those of a factual nature
- There would only be reporting after the event, without the need for any prior endorsement by the regulator; and

- The regulator would particularly monitor cases where access negotiations have been unsuccessful.

The companies consider that a third party access policy and ring fencing proposals formulated by the service provider in a public code of conduct should be sufficient for a vertically integrated supplier to be able to be price monitored. A public disclosure of ring fencing proposals is a powerful incentive for a service provider to stick to the terms of the commitment. For a non-vertically integrated supplier there should only be the requirement for a public commitment to open access.

The companies consider that this voluntary commitment to ring fencing and open access is a less costly and more powerful incentive to ensure appropriate behavior.

Finally, the companies support the recommendation for the regular publication of non-confidential data collected under a monitoring regime with any accompanying commentary restricted to matters of a factual nature only.

4.2 Quality of Service Monitoring and Commercial Agreements

In terms of the public disclosure of information the companies consider that quality of service monitoring will be required under price monitoring. It is a useful adjunct to price monitoring, as it helps to ensure that utility operators do not seek to increase profits by reducing costs to levels that impact adversely on standards of service. Quality monitoring of services may also identify whether utilities are investing appropriately, for example, by investing in new facilities to improve levels of service or responding to increases in demand or responding to customer preferences.

The companies agree with the Commission’s assessment that there is merit in supporting the development of commercial agreements. However, it is not clear that the Commission or the regulator needs to, or should, play a role in preparing guidelines for the conduct of those negotiations or the content of particular agreements that may take various forms and cover any variety of matters. The companies are conscious of the costs that would arise from a highly prescriptive regulatory process, and consider that it is the parties affected that are best placed to determine these matters in a manner that suits their particular operational needs.

4.3 Independent Review and Assessment

The companies support the Commission's recommendation that there be an independent review towards the end of the five year regulatory period to assess the need for continued price monitoring. It is understood that this review would be an assessment of each company’s actual performance during the initial five-year price monitoring period. Sufficient time needs to be given for the utilities and customers to bed down a commercially negotiated operating environment. In that regard there is an expectation that utility operators will implement transitional arrangements that recognise the impacts on the industry from adopting efficient pricing principles, and will negotiate with customers a path by which they may be achieved over time.

In particular, in relation to the arrangements for moving between the price monitoring and ‘reference tariff’ tier, the companies consider that allowing a regulatory authority to lodge applications for changes in the form of regulation is inappropriate given the predisposition for regulators to impose strict controls on companies, without detailed assessment guidelines to guide the independent review.

The key considerations to guide the five-year review should be based on the following:

1. In utilities without significant capacity constraints or old pipelines, efficient prices broadly should generate expected revenue that is not significantly above the long-run costs of efficiently providing the utility services. Prices should allow a return on (appropriately defined and valued) assets commensurate with the regulatory and commercial risks involved;
2. Price discrimination and multi-part pricing that promotes efficient use of the utility services is permitted. This may mean that some users pay a price above the long-run average costs of providing utility services, whereas more price-sensitive users pay a price closer to marginal cost;
3. In utilities with significant capacity constraints or old pipelines, efficient peak/off-peak prices may generate revenues that exceed the production costs incurred by the utility. Such demand management pricing practices should be directed toward efficient use of utility infrastructure and, when not broadly revenue neutral, any additional funding that is generated should be applied to the creation of additional capacity or undertaking necessary infrastructure improvements;
4. Whether quality-of-service outcomes have deteriorated and/or failed to meet the preferences and reasonable requirements of customers;
5. The extent to which commercial agreements on prices and quality of service have been negotiated satisfactorily;
6. The degree of effective consultation with customers and the extent of exchange of information;
7. The number and application for third party access seekers and the extent and validity of customer complaints.

Quality of service outcomes should be consistent with user's reasonable expectations, and consultation mechanisms could be established with customers to facilitate the two-way provision of information on utility operations and requirements.

It is expected that utilities and their customers will primarily operate under commercial agreements and in a commercial manner, and that utility operators and users will negotiate arrangements for access to pipelines.

The companies consider that the principles outlined above should also form the basis of the future five-year review, taking into account intervening industry developments.

Recommendation 5

That the Commission proposes the key assessment criteria for the independent 5-year review as set out above.

5. Need to Reform the Setting of Reference Tariffs

In Chapter 7 the Commission concluded that there were a number of problems with the current regulatory approach of approving reference tariffs.

> "This chapter highlighted a number of other problems with the current regulatory approach of having access arrangements with reference tariffs, including:

- High regulatory risk — service providers cannot be certain about the regulatory parameters and mechanisms that will be applied to their pipeline, despite the many pages of the Gas Code and the Gas Pipelines Access Law
- Detailed information requirements are costly and intrusive
- Increased complexity due to the apparent tendency of regulators to adjust regulatory depreciation to deal with deficiencies of the Gas Access Regime
- 'Capacity hoarding' of unutilised contracted capacity on contract carriage pipelines might be limiting competition in upstream or downstream markets."

The Commission made a number of recommendations on how to improve the cost-effectiveness of the current regulatory approach but no recommendations were made on how the approval of reference tariffs would operate despite the Commissions criticism of the model used. It is important to ensure that in the development of a new approach to the Code, if distributors remain on the setting of reference tariff model as this encourages dynamic investment.

The companies consider that while the pricing principles proposed for Section 8.1 of the National Gas Code are broadly appropriate, some modifications are required that are related to some recent legal decisions.

While supportive of the Commission's proposed establishment of a price monitoring option the companies urge the Commission to continue to focus on improving the quality and reducing the cost of for utilities under the reference tariff approval model 'reference tariff' regulation. Depending on approaches by coverage bodies and judicial decisions, it is likely that a number of significant gas pipelines and networks could possibly be regulated under this more intrusive form of regulation. Improvements to minimise regulatory costs and the risk of regulatory error and failure in this area must not be neglected simply because an alternative 'price monitoring' option may exist.

There have been a number of relatively recent court decisions on the interpretation of the Gas Code and these developments need to be taken into account by the Commission in the design of the new Gas Code. This is because legal interpretation of codes and legislation provide a valuable service in balancing interests between regulators and companies and is a basis of the legal framework in developed countries where parliament's legislate and the court's interpret the legislation to ensure that private property rights are protected. The regulatory process involves substantial discretion by regulators and review by the courts provide an important mechanism for the protection of private property rights. The Commission has strongly supported the concept of merit review in the Draft Report and the review of regulatory decisions by the courts. It therefore follows that the Commission should adopt where relevant the decisions of such courts.

5.1 Workable Competition as the Market Test in the Code

The Commission leaves the impression in the Draft Report that decision of the Full Bench of the West Australian Supreme Court (WASC hereafter) (*Re Dr. Ken Michael AM; Ex Parte Epic Energy (WA) Nominees Pty Ltd and Anor* (2002) WASCA 231 was not a particularly useful addition to the regulatory debate. The WASC decision in para 31 that the essential issue was the existence of:

> "A fundamental difference between the view of the Regulator and Epic as to the true interpretation of material provisions of the Code . . . Unless the issues of statutory interpretation can be resolved, the processes of further submission and further decision seem unlikely to offer the prospect of any material change of position by the Regulator."

That is, the WASC believes that there exists a fundamental need to establish what it is that the Code seeks to achieve. It was noted at para 87 by the WASC that when it came to discovering the:

> "True interpretation" of various provisions in the Code, "a purposive interpretation is to be preferred to any other. By virtue of the special interpretative provisions consideration may be given to extrinsic material if a provision of the Code is ambiguous or obscure or if the ordinary meaning leads to a result that is manifestly absurd or unreasonable. Extrinsic material may also be used to confirm that the meaning of a provision is the ordinary meaning. In determining the ordinary meaning regard would normally be had, of course, to the ordinary meaning conveyed by a provision having regard to its context and to the scope and purposes of the Code."

The WASC decision (Para 88) also referred to the original Hilmer Report, which had argued that:

> "Competition policy is not about the pursuit of competition *per se*. Rather, it seeks to facilitate effective competition to promote efficiency and economic growth, while accommodating situations where competition does not achieve efficiency or conflicts with other social objectives."

It is clear from this statement that the WASC believes that economic regulation was not about competition per se but about facilitating effective competition. The judgment was concerned that there was little agreement on how to interpret any of the key economic concepts that underscore the regulatory process. The crucial term's "competition" and "market" were among them. Ultimately the judgement concluded in para 124 that:

> "In the field of competition policy, especially market regulation, the prevailing view and usage among economists is that a reference to a competitive market is to a workably competitive market. In the particular context of the promotion of a competitive market for natural gas it would be surprising if what was contemplated was a theoretical concept of perfect competition, as the subject matter involves very real life commercial situations. Workable competition seems far more obviously to be what is contemplated."

In saying this, the WASC was stressing the need for regulation to be built on a framework of the actual operating environment in which the regulated firm is doing business, rather than imposing unrealistic conditions on market participants that have been derived from theoretical models that do not reflect reality.

However, after having decided that workable competition was an appropriate base on which to make regulatory decisions, the judgement noted at para 126 that this model did not in effect permit the regulator to come to a necessarily unique conclusion, either in any given case or between cases:

> "It is my conclusion that in the preamble to the Act and the introduction to the Code the concept of a "competitive market" is that which economists in this field would understand to be a workably competitive market. That having being said, however, it is clear from the evidence that there is division among economists as to how the concept is promoted where it does not exist, and how its outcomes

can be artificially created in a monopolistic situation. A fundamental reason for this is that a workably competitive market is itself a variable and varying state of things – or rather it is a process. The evidence and the many supporting documents placed before us suggest this is a field of very active endeavour by economists, with older views being constantly further developed and new views emerging. The clear impression from the evidence is that there has been noticeable development in the prevailing economic understanding of these things in the period since December 1997."

The judgement went on to say at para 128:

> "It is of some relevance to notice, however, that as a competitive market, in this sense of an economist's understanding of a workably competitive market, is not a fixed and immutable condition with any absolute or precise qualities, but a process which involves rivalrous market behaviour . . . a workably competitive market will react over time and according to the nature and degree of various forces that are happening within the market. There may well be a degree of tolerance of changing pressures or unusual circumstances before there is a market reaction. The expert evidence and writings tendered in evidence suggest that a workably competitive market may well tolerate a degree of market power, even over a prolonged period. The underlying theory and expectation of economists, however, is that with workable competition market forces will increase efficiency beyond that which could be achieved in a non-competitive market, although not necessarily achieving theoretically ideal efficiency."

In other words, the model of workable competition provides the flexibility to adapt to different market circumstances. The Court concluded at paras 185 and 187 that it was the regulator's task to evaluate the tradeoff between objectives and found that:

> "the scheme of the Act and the Code is to leave this potential conflict which, in part, is between the interests of a service provider in achieving a return on its investment in the pipeline and the interests of users or consumers in achieving a lower price and indeed, perhaps, in the achievement in the public interest of greater competitiveness or the effects of competition, to be resolved by the Regulator in accordance with the Act and the Code and the circumstances of each particular case . . ."
>
> It must be remembered, however, that once the basic issues of interpretation are clarified it is for the Regulator, not this Court, to consider and weigh those factors and objectives. It is for the Regulator to assess the relevance and weight of each of these factors and objectives and to exercise the discretions that are committed by the Code to him."

The companies consider that the WASC decision is an important contribution to the regulatory pricing debate that should be taken into account in the development of a new Gas Code. That the existing pricing model is based on perfect competition is not in doubt as:

- All regulators use the CAPM model, which requires the assumption of perfect competitive market equilibrium for it to be used for the precision that Australian regulators adopt
- Regulators use instantaneous adjustments to new pricing levels which is consistent with a text book version of perfect competition
- Assessments of cost invariably go to the lowest level which is consistent with concepts of perfect competition.

Professor David Round has also commented on the issue of workable competition and the WASC decision:

> "In this decision, the first to be made by a superior court in Australia on what type of competition is being sought in the prescriptions of the *National Third Party Access Code for Natural Gas Pipeline Systems 1997*, fundamental issues and challenges are raised to the regulatory framework used to date

by the ACCC and other Australian regulators. I believe that the approach determined by the WASC is the correct one and is in line with modern thinking by economists."7

Professor Round found that workable competition was an important economic principle on which to base access regulation and to encourage dynamic investment:

> "It is also crucial to have an operating framework for competition that is flexible enough to cope with the wide variety of dynamic corporate strategies that are called into play as part of the competitive process. There cannot exist a simple "one-size-fits-all" model. Different firms will have different ways of seeking to attract and retain customers, and a given firm will likely be changing its tactics at different points of time as it responds to varying market conditions. To assess all behaviour through the behavioural straightjacket of the perfectly competitive model that focuses on the short run is analytically incorrect and, as well, leads to policy enforcement with serious implications for social welfare. The approach of the WASC, in contrast, by invoking the notion of workable competition, while providing no magic formula for regulation, at least opens regulators' eyes to the need for flexibility and a careful dynamic multi-period analysis of the unique characteristics of each market.
>
> The appropriate approach for a regulator is a two-step one. First it should ask whether the regulated company has put forward a charging regime, or a package of price/product/service offerings, that is consistent with what could be observed in a workably competitive market? Then, for the sake of regulatory prudence, it should go one step further and investigate to see whether any dynamic change or improvement could be suggested, or imposed, for which the marginal social benefit of the change over the relevant time period outweighs the marginal social cost of that change. If the answer to this question is no, then the proposed charging regime or package is socially efficient and consumer welfare will be at the optimum level."[8]

In addition there have been a number of other judicial precedents that occurred either following the Draft Report or at a time when much of the Draft Report had been substantially finalised that also support the concept of workable competition. These include the:

- Federal Court decision regarding Australia Gas Light's (AGL) proposed participation in the sale of the base load Loy Yang generator in Victoria; and,
- Decision by the Minister for Industry, Tourism and Resources to remove coverage over substantial sections of the Moomba-Sydney Pipeline

In the above decision revoking coverage of elements of the Moomba-Sydney Pipeline system, the Minister provided reasons that support the concept of workable competition outlined in the WASC case. For example, he states at par 147:

> "While an efficient tariff may deliver significantly lower gas prices to customers of gas transported by the MSP, the presumption behind the Council's analysis is one of a more or less permanently regulated pipeline facing diminishing regulated tariffs down to long term economic costs. Maintaining access regulation to push tariffs down to a theoretical perfect competition level will not serve the long-term public benefit if this results in under-investment in gas pipelines and an associated inability to promote competitive gas supplies. In such circumstances, regulation would become a surrogate from market competition and the costs (direct and indirect) are likely to exceed the long term public benefit"

The recent judgement by Justice French in the AGL v Australian Consumer and Competition Commission (ACCC) case over the purchase of the Loy Yang generator has also supported a concept of looking at the actual market in existence rather than relying on a theoretical model of competition.

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7 David K Round. Workable Competition: A Modern Interpretation of the Dynamic Process of Competition, p.4, in an Appendix to the Allgas Energy Submission, February 2004.

8 Ibid p. 13.

Such an approach based on workable competition invalidates the use of the CAPM model when it is used to establish a unique price. This presents a major problem for the approval of reference tariffs in a workable competitive market. An approach which best meets the criteria of a workably competitive market but allows the CAPM only to be used as a check on rates of return could use a range of CAPM measures that was within acceptable commercial boundaries. Recent legal precedents also support such an approach that could apply to companies regulated under the reference tariff approval model.

5.2 Other Legal Precedents

The other key legal precedents under the gas access regime since the release of the Draft Report include the Australian Competition Tribunal's (ACT) rulings in the:

- A*pplication of GasNet Australia (Operations) Pty Ltd [2003]* in relation to a decision by the ACCC to draft and impose an Access Arrangement for the Victorian gas transmission system owned by GasNet Australia (GasNet case);
- *Application of Epic Energy South Australia Pty Ltd [2003]* in relation to a decision by the ACCC to draft and impose an Access Arrangement for the Moomba-Adelaide Pipeline System (MAPS case).

5.2.1 The GasNet Case

The GasNet decision established important principles on the:

- Use of a long term bond rate to determine a rate of return
- Use of an appropriate methodology of estimating inflation;
- Insurance costs and risk management; and
- The role of the regulator in assessing reference tariffs as part of an access arrangement.

Long Term Bond Rate

The ACT determined that:

> "The ACCC erred in concluding that it was open to it to apply the CAPM in other than the conventional way to produce an outcome which it believed better achieved the objectives of s 8.1. In truth and reality, the use of different values for a risk free rate in the working out of a Rate of Return by the CAPM formula is neither true to the formula nor a conventional use of the CAPM. It is the use of another model based on the CAPM with adjustments made on a pragmatic basis to achieve an outcome which reflects an attempt to modify the model to one which operates by reference to the regulatory period of five years. The CAPM is not a model, which is intended to operate in this way. The timescales are dictated by the relevant underlying facts in each case and for present purposes those include the life of the assets and the term of the investment"[9]

In adopting a different version of the CAPM, the Tribunal considered that the ACCC was not applying the CAPM, and hence was in breech of the Code.

9 Paragraph 47. Australian Competition Tribunal, Application by GasNet Australia Pty Ltd [2003] ACompT 6

Recommendation 6

That the Commission recommends that a new section be placed in the Gas Code (Reference Tariff Approval) dealing with how the CAPM model is to be used in determining reference tariffs in the context of a workably competitive market for utilities under the reference tariff approval model.

Recommendation 7

That the Commission recommends that in approving reference tariffs via the CAPM model that the relevant bond rate to use is one consistent with the life of the asset and the longest dated domestic bond.

The Role of the Regulator

The Tribunal was also critical of the ACCC's position that it needed to determine the appropriate return. The Tribunal strongly argued that the requirement of the regulator under the Code is to only propose an alternative Access Arrangement when that proposed by the Applicant (in this case GasNet) does not comply with the Code. In paragraph 42 of its decision, the Tribunal noted:

> "Contrary to the submission of the ACCC, it is not the task of the Relevant Regulator under s 8.30 and s 8.31 of the Code to determine a '*return which is commensurate with prevailing conditions in the market for funds and the risk involved in delivering the Reference Service'*. The task of the ACCC is to determine whether the proposed AA in its treatment of Rate of Return is consistent with the provisions of s 8.30 and s 8.31 and that the rate determined falls within the range of rates commensurate with the prevailing market conditions and the relevant risk."

The Tribunal noted that consistent with the WASC decision on Epic, any decision on an Access Arrangement should reflect the underlying uncertainty of the parameters, and that the application of Reference Tariff Principles involves "issues of judgement and degree".[10] Given this uncertainty, plus the need to assess the proposed Access Arrangement, the Tribunal stated that the onus was on the regulator to best resolve any tensions in ways that were consistent with the legislation. In paragraph 29 of the decision the Tribunal states:

> "It is clear in the reasoning in Michael that there is no single correct figure involved in determining the values of the parameters to be applied in developing an applicable Reference Tariff. The application of the Reference Tariff Principles involves issues of judgement and degree. Different minds, acting reasonably, can be expected to make different choices which nonetheless remain consistent with the Reference Tariff Principles. Where the Reference Tariff Principles produce tension, the Relevant Regulator has an overriding discretion to resolve the tensions in a way, which best reflects the statutory objectives of the Law. However, where there are no conflicts or tensions in the application of the Reference Tariff Principles, and where the AA proposed by the Service Provider falls within the range of choice reasonably open and consistent with Reference Tariff Principles, it is beyond the power of the Relevant Regulator not to approve the proposed AA simply because it prefers a different AA which it believes would better achieve the Relevant Regulator's understanding of the statutory objectives of the Law."

10 Full Court of the Supreme Court of Western Australia in Re Michael Ex parte Epic Energy (WA) Nominees Pty.Ltd (2002) 25 WAR 511.

Recommendation 8

The Code should specify that, in approving reference tariffs, the relevant regulator assesses the distributors for conformance with the Code and if the CAPM variables are within a commercially acceptable range that the regulator must approve the reference tariff levels for utilities under the reference tariff approval model.

Self Insurance Costs

During the GasNet proceedings the ACCC conceded that it was appropriate for GasNet to be provided with an allowance to self-insure against uplift liability risk, key person risk and employment practices risk, and that any costs associated with counterparty default and terrorism should be treated as a pass through item. The issue of insurance has been a concern in many regulatory decisions at both the ACCC and state levels.

Recommendation 9

That cost effective and efficient insurance is permitted by the National Gas Code and that counterparty default and terrorism should be pass throughs in reference tariff decision for utilities under the reference tariff approval model.

5.2.2 The Moomba Adelaide Pipeline System (MAPS) Decision

Efficient Costs

In its decision on the MAPS the Tribunal was critical of the ACCC's decision to determine the cost of line pipes based on the lowest internationally available price at a particular point in time.[11] Again, the Tribunal noted the uncertainty over the values to be adopted, and also highlighted the asymmetric consequences of the errors involved in adopting this value. It noted:

> "For planning purposes, however, this price cannot be known with any certainty and a prudent operator would likely find it to be commercially unwise to plan a pipeline project based on the lowest known line pipe cost, or even the average line pipe cost of suppliers in the lowest-cost producing country. The risk here is highly asymmetric, all on the upside. Thus a prudent operator, in the absence of perfect information, would factor into its estimates the expected value of line pipe costs, based on its estimation of the range of likely future prices and the assessed probability of occurrence of each possible price.
>
> In the absence of knowledge of such a probability distribution at the planning stage, an operator might therefore obtain some indicative estimates based on less-than full information being available, compared with a specific tender to job specifications, and take either a simple arithmetic average, a modified arithmetic average, or the median of these prices as the indicative planning parameter value. It would be a highly risky commercial action to take the lowest figure found in any such non-detailed price-seeking activity."

This was the second time in a matter of a few weeks that the Tribunal has been critical of the ACCC's increasing tendency to seek to adopt the lowest possible parameter value, regardless of the regulatory requirements.

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11 Australian Competition Tribunal, Application by Epic Energy South Australia Pty Ltd [2003] ACompT 5. Paragraphs 63-64.

Recommendation 10

That the Commission recommends that the lowest cost of equipment is not a requirement under the Gas Code and note that there are numerous reasons why the lowest cost for equipment should not be used for example in term of quality, delivery capability and timeliness of delivery.

Market Power

The Tribunal also made an important determination on the issue of market power:

> "Even if market power exists, it is still necessary to ask if the ACCC acted reasonably in exercising it discretion in requiring coverage of the Pelican Point expansion? One of the factors to be considered in assessing an AA is the legitimate business interests of the service provider (s 2.24 (a) of the Code), and there is no mention of that factor in the ACCC's assessment of the inclusion of the Point Pelican expansion in the covered pipeline, even though Epic raised it in its submissions on the Final Decision. ……..
>
> The Tribunal finds that there were no factual circumstances which would have entitled the ACCC to reasonably conclude that EPIC would be able to exercise any market power of a significant nature in the market for IT service. The ACCC did not provide any cogent explanation of what the mechanism was, through Epic could systematically act to exercise any market power, nor did it provide any evidence as to what the effects would be, or who would be affected, and for how long the effects would last. The ACCC could do no more than say that in the absence of proof that the Pelican Point expansion '*was fully contracted in every sense of the word*' then it was correct for it to conclude that Epic could potentially exercise market power in the supply of IT services. That, in the view of the Tribunal, was not a sufficient basis to conclude that the Pelican Point expansion ought to be covered and included in the SPC of the Pipeline System available for the provision of a FT service being the Reference Service Epic lodged on 1 April 1999. Nor was it open for the ACCC to come to the decision which it did without due consideration of the legitimate business interests of Epic which the ACCC failed to consider."[12]

This conclusion of the Tribunal supports a number of code changes:

- A regulator under the National Gas Code needs to assess Section 2.24 factors (including the legitimate business interests of the service provider) in making a decision on coverage of system expansions[13]
- In the absence of detailed market and factual analysis, the theoretical possibility of the potential abuse of market power is insufficient for a regulatory authority to require a pipeline to covered or moved from price monitoring to having its reference tariffs approved[14]
- The mere presence of excess demand for a service is not necessary or sufficient to prove that market power exists, excess demand is only one indicator of potential market power for covering a pipeline or moving from Tier 2 to Tier 1[15]

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12 Application of Epic Energy South Australia Pty Ltd [2003] ACompT5 pp.28-29

13 Application of Epic Energy South Australia Pty Ltd [2003] ACompT5 [48]

14 Application of Epic Energy South Australia Pty Ltd [2003] ACompT5 [120]

15 Application of Epic Energy South Australia Pty Ltd [2003] ACompT5 [102] cf. Productivity Commission (December 2003), p.179

- Coverage under the National Gas Code and movements from Tier 2 to 1 should only be pursued if market power that is 'non-transient and non-trivial' is shown to be present and that a 'not trivial' increase in competition can be expected to follow.[16]

5.2.3 Section 2.24 (a) of the National Gas Code

The WASC and other legal decision has also shown that Section 2.24 (a) of the Code has been the basis of important legal precedent, which has protected the property rights of utilities in past legal decisions.

However, the Commission has proposed substantially amending the existing Section 2.24 of the National Gas Code to remove the requirements for a regulatory authority to consider a range of potentially conflicting objectives set out in clauses (a)-(g).

The companies do not support the removal from Section 2.24 of clause (a) which states that the regulator must take into account when assessing an Access Arrangement '…the Service Provider's legitimate business interests and investment in the Covered Pipeline'. While the companies support the streamlining of the range of existing potentially conflicting objectives set out in the regime, it considers the removal of this clause to be inappropriate due to the legal precedent around it.

It is important to note that third party access is, ultimately, an abrogation of property rights in that it interferes with the right of owners to allow access to a facility on terms and conditions they deem fit. While the companies accept that there may be sound public policy reasons for such an interference with property rights, the strong presumption in Australia that property rights should be upheld means that there needs to be explicit recognition of these rights. This is currently done by section 2.24(a) and, were this to be removed, there would no longer be any clear requirement to consider the owner's property rights.

Recommendation 11

That the Commission recommends that the above Tribunal decisions are included in the new National Gas Code for both price monitoring and reference tariff approval where relevant.

Recommendation 12

That the Commission recommends that Section 2.24 (a) is retained in the Code objectives.

5.3.3 Efficiency Mechanisms and Reference Tariff Setting

In setting reference tariffs for utilities under the reference tariff approval model the issue of efficiency mechanisms is important given the need to encourage productivity.

Chapter 9 of the Draft Report appears to be the only segment of the report that considers incentive mechanisms but restricts the discussion to how they interact with asymmetric truncation. The companies agree that an incentive mechanism will not impact on truncation, however, this does not mean it is not worth considering for other reasons such

16 Application of Epic Energy South Australia Pty Ltd [2003] ACompT5 [104, 113] Note this is similar to key recommendations made by the Productivity Commission on coverage, see Draft Finding 6.1 and 6.2 in Productivity Commission (December 2003), p.156 and p.173

as encouraging productivity. The companies are concerned that the Draft Report does not appear to consider how incentive mechanisms should be designed let alone express any conclusions on the subject. The companies urge further consideration of this issue and notes the following:

- As noted in table 9.1, the benefit-sharing ratio between service providers and users varies between less than thirty through to fifty per cent. The companies believe that a workably competitive market would apply a higher rate of say 50% and urges the Commission to explore this aspect in greater detail

- Table 9.1 also notes that half of the incentive mechanisms examined have an inter period sharing mechanism. The companies believe this is highly desirable as it maintains the incentive to be efficient at the same level regardless of when in the access period it occurs.

Recommendation 13

That the Commission recommends that efficiency carryovers should be specified in the new Code when a regulator sets reference tariffs and the basis of sharing should be 50:50. The Commission should also propose how the carryover should work to ensure consistent application across Australian regulators.

7.0 Regulator Assessments of Contracts

7.1 Asset Management Contracts

The Commission has raised the issue as an information request as to whether a regulator should have the power to examine the costs of an asset management business wholly owned by the service provider as part of an access arrangement review.

Firstly, the companies believe this suggestion is contrary to a correct interpretation of the Code. The intent of the Code provisions in this area is to ensure that a vertically integrated distributor/retailer cannot abuse its position by artificially favouring its retail operation while making other access users pay a higher price. Such an incentive simply does not arise with an asset management contract.

Secondly, the companies do not support such a proposal as they face strong commercial pressures to maintain adequate service levels to their customers and to meet shareholders' requirements to maximise returns within commercial, health and safety, and environmental constraints. The company believes that these factors provide the necessary incentives to achieve efficient levels of capital and operational expenditure.

In support of this proposition in the recent Gas Access Arrangements decision in Victoria by the Essential Services Commission (ESC) the regulator accepted that capital expenditure during the first regulatory period should be taken to have met the Code's requirements. This implies that they found no problem with asset management contracts.

However, the companies do not necessarily accept that the regulatory regime itself has provided these incentives, as is claimed by the ESC in Victoria. The companies work diligently to have gas supply incorporated into new projects and to repair existing services. The companies promotion of gas as a fuel of choice is based on the concept that

competitive offers must be made at the development stage of new estates, or the particular business growth opportunity may be lost for 20 years, if not permanently.

The companies do not believe that there is an ability to exert market power issue in capital and operations expenditure in gas distribution. Gas can be substituted by electricity or other energy forms in all but some specialised industrial and domestic processes. The companies have long sought to compete at the project development phase by providing the basic assets (within reason) at no cost to the developer in order to become involved in these developments.

The companies do not support the imposition of a mandatory obligation under the Code for the regulator to be able to approve or assess asset management contracts. Distributors already have obligations under Customer Service Codes to make offers on fair and reasonable terms when new connections are involved. The competitiveness of offers with respect to other energy sources can only be determined within the competitive marketplace for energy.

The companies consider that distributors can only make decisions on work on their networks based on sound business principles and in line with their regulatory and shareholder obligations. To proceed on any other basis would potentially place the business and its Directors in breach of these obligations.

In any case the regulator currently has powers to approve all costs during the approval of reference tariffs and any additional requirements on asset management contracts are unnecessary. Under these conditions the regulator benchmarks unit costs, which include asset management costs and this, enable an assessment of those overall costs.

The Commission also point out that the only possible reason to approve or assess asset management contracts is for the issue of 'transfer' pricing and that this does not directly impact on upstream or downstream competition. The reasons outline above would ensure that any proposal to extend the Code to assess or approve an asset management contract would not be a net benefit to the public.

The Commission argued that regulators could not assess the issue in any case:

> "Requiring service providers to gain regulator approval for asset management contracts has the potential to impose costs on service providers. The only reason for regulatory intervention in asset management contracts is to address the possibility of transfer pricing (section 10.1). However, the regulator can refuse to approve an associate contract only if it has, or is likely to have, the effect of substantially lessening competition. Given that transfer pricing does not directly impact on upstream or downstream competition, the regulator is unlikely to be able to effectively address transfer pricing through seeking oversight of asset management contracts. In any case, because the regulator has no information about the costs of the asset management business, it is unlikely to be able to assess whether the contractual conditions are reasonable."

This analysis indicates that there are no valid reasons for a regulator to assess an asset management contract.

Recommendation 14

That the Commission recommends that regulators should not have the power under the Code to review asset management contracts between utilities and their asset management business.

7.2 Associate Contracts for the Supply of Services at the Reference Tariffs

In the Draft Report the Commission recommended that:

> "Section 7.1 of the Gas Code should be amended such that a service provider entering an associate contract for the supply of services at the reference tariff must notify the relevant regulator, but is not required to seek authorisation." (p,333)

The Commission acknowledged that little benefit is associated with regulator approval of such a contract, given that (subject to capacity) all other access seekers can gain access at the same terms and conditions. However, they suggested that the costs of the process could be reduced further by amending s.7.1 of the Code, such that the service provider is required to notify the regulator of its intention to enter an associate contact for the supply of services at the reference tariff, rather than being required to seek authorisation. Under such an arrangement, the regulator can verify that the contract is for a standard unbundled transportation service at the reference tariff and, if so, it should have no grounds for withholding approval.

Recommendation 15

That the Commission recommends that a service provider entering an associate contract for the supply of services at the reference tariff must notify the relevant regulator, but is not required to seek authorisation.

8.0 Administrative and Appeal Processes

The companies strongly support the recommendations concerning extension of the merit appeal provisions and timeliness and believes these would both improve the Code significantly. Timeliness of regulatory decisions has been a particular issue in Western Australia and the companies believe, despite the acknowledged complexity of the issues, a factor has been the unfettered ability of regulators to obtain as many extensions as they wish, essentially without any need for justification.

The companies do not agree, however, with the assessment of the regulatory funding arrangements. The Draft Report concludes:

> "funding arrangements in Western Australia have features of well designed cost recovery."

While there can be sound arguments for recovering the costs for users (just as there are for recovering costs from general revenue as with the ACCC), the cost recovery regime in WA has some particularly egregious features:

- Costs are recovered directly from users on the basis of expenditure. This means the Regulator can spend as much as he wishes in the knowledge that it can be recovered

- Regulated entities have, as a result of this feature, little ability to forecast actual regulatory costs and as a result can under recover regulatory costs via their access arrangements, and

- The Regulator in WA has proved reluctant to allow actual regulatory cost recovery in access arrangement mechanisms.

The companies believe that further attention should be given to funding from consolidated revenue as is the case with the ACCC on the basis that if regulation benefits the whole economy then the most efficient way to recover those costs is via broad based taxation.

But even if user cost recovery is advocated, significant improvements on the WA system could be achieved from:

- Setting a fixed budget for the regulator, which could be recovered from users as now, with the essential difference that the regulator would have to live within that budget. Any overspend, as with any other government agency, would be a matter for the agency and the Minister; or
- Allowing for the actual costs of regulation to be recovered via the access arrangement mechanism rather than forecasts. This would also provide a constraint on regulatory costs, as the regulator would need to take account of the impact on customers.

Recommendation 16

That the Commission recommends that the new Gas Code should allow all the actual costs of regulation by the regulator to be recovered from consumers.

It is hoped that these comments are of assistance. The companies look forward to participating in the proposed public forum. If any further information is required please contact Julie Bull, Manger Regulation and Strategy on (03) 9556 1551 or Geoff Towns, Manager Economic Regulation on (03) 9556 1546.