

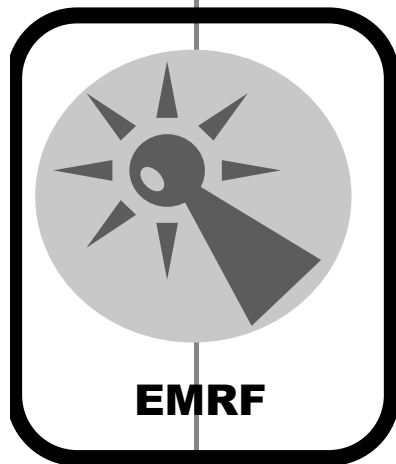
ENERGY MARKETS REFORM FORUM RESPONSE

PRESENTATION TO
THE PRODUCTIVITY COMMISSION'S
DRAFT REPORT ON
THE NATURAL GAS ACCESS REGIME

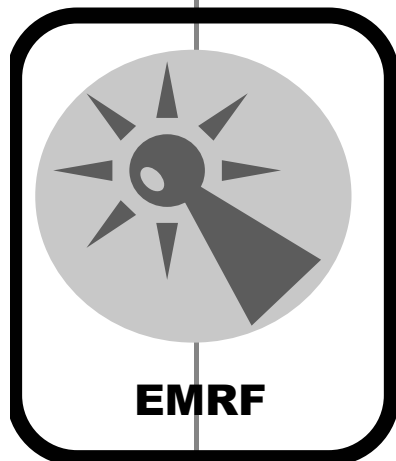
PUBLIC HEARING
FRIDAY 26 MARCH 2004

PRESENTED BY

MR BOB LIM – ADVISOR, EMRF
DR TERRY DWYER - CONSULTANT



1. Thanks to the Productivity Commission for opportunity to present views.
2. Energy Markets Reform Forum comprise a number of companies including:-BHP Billiton, BlueScope Steel, Hydro Aluminium Kurri Kurri, AMCOR, Tomago Aluminium, Visy Paper and Orica
3. Overall view of Draft Report
 - Disappointing: highly contentious and inappropriate recommendations that will whittle away the benefits gained from Gas Access Regime in recent years and substantially disadvantage upstream and downstream investments moving forward.
 - It is intellectually flawed: fails to present an economy-wide assessment of the deadweight losses caused by monopoly pricing of strategic infrastructure and seems to assume monopoly away.
 - It has not met the terms of reference of the Review
 - many places where evidence from consumers and non-pipeline industry simply ignored;
 - inadequate investigations;
 - full of assertions in many areas, with no evidence provided.
 - Certain Draft Recommendations are so dangerously flawed, the risks of distorting the operation of the Gas Access Regime are very disturbing.

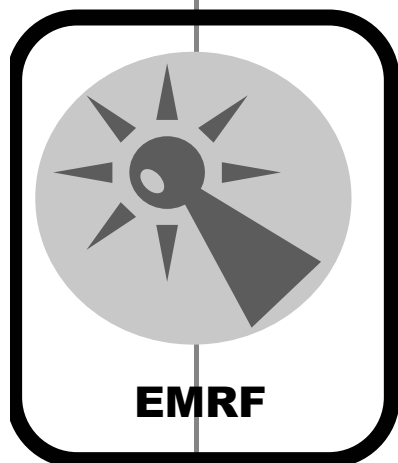


MARKET POWER

Draft Report: Market power is constrained by a number of factors e.g. availability of substitutes, the size and concentration of users, elasticity of demand for the final products.

Energy Markets Reform Forum's Response:

- Failure to recognise evidence provided by end users that ability to substitute energy sources for gas is limited e.g. technically and contractually (gas used as feedstock; long-term contracts; technical considerations and costs in switching).
- The structure of the NSW gas market: vertically-integrated dominant gas retailer, involving distribution networks and significant ownership of a major gas transmission business.
- Even two pipelines, as in NSW, do not provide evidence of no market power (e.g. for EGP to increase its market share it is dependent on Gippsland Basin producers increasing production and supply).
- The elasticity of demand for gas sold into intermediate markets may be higher than AGA/ABARE estimates
 - that a small price charge in gas could make a proposed generator vulnerable to displacement.
 - examples provided where a price difference of \$2.25/MWh of output resulting from a gas price charge of \$0.28/GJ (being the difference between an ACCC draft decision and an EAPL application) could have a significant difference on gas fired electricity generator where new entrant pricing is \$35.40/MWh.
 - and also for a fertilizer producer this difference equates to \$5.50 in a product that wholesales around \$280/te.

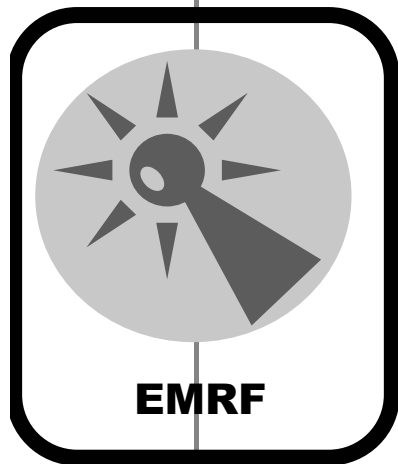


MARKET POWER CONTINUED

Draft Report: Effective competition is “evolving”.

Energy Markets Reform Forum’s Response:

- 2 pipelines do not necessarily mean competition (2 airlines policy: limited competition and services: parallel scheduling and parallel pricing).
- Premature: no real alternatives in transportation of gas from one basin to the same regional market.
- No assessments of overseas experience e.g. US gas market (mature) but yet with 300 or so competing pipelines very strong regulatory regime . Why?

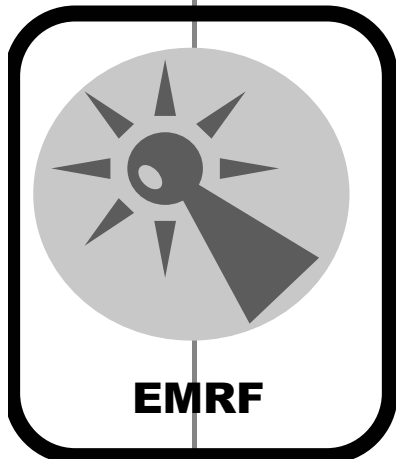


DETERS AND DISTORTS INVESTMENTS

Draft Report: The Regime deters and distort investments, possibly altering the nature and timing of pipeline projects. Delays to pipeline construction or pipelines built 'fit for purpose'. (The Draft Report uses words like "strong likelihood" of investments in pipelines has been affected by the Gas Access Regime.

Energy Markets Reform Forum's Response:

- The Draft Report Framework
 - ignores wider issues e.g. deadweight losses from monopoly rents.
 - focuses on investment in pipelines.
 - no evidence provided (or even investigation undertaken) of deterrence and distortion.
 - no cost benefit analysis provided of access regulation (e.g. not one regulatory decision assessed).
 - no NCC coverage decision assessed.
 - no investigation of WACC's given by regulators or even whether investments were deterred as a result (e.g. paper on Further Capital Markets Evidence In Relation To The Market Risk Premium And Equity Beta Values show that real pre-tax returns earned in competitive market in the period 1989-2000 average 4% *c.f.* pre-tax WACC's awarded by regulators of 6-8%).
 - note that NCC coverage criterion (d) – the public benefit test - at least undertakes cost-benefit analysis. Where is the PC's analysis?

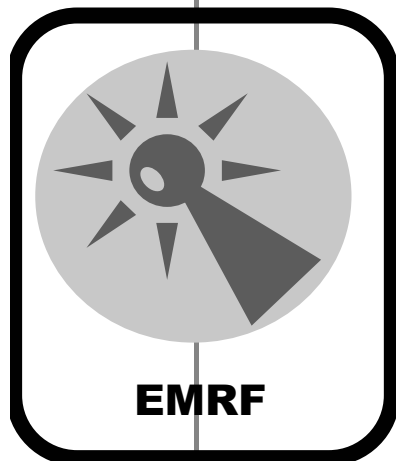


SIGNIFICANT COMPLIANCE COSTS?

Draft Report: There are significant compliance and administrative costs. Delays have added to costs.

Energy Markets Reform Forum Response:

- No evidence or data provided.
- Has marginal costs exceeded marginal benefit?
- Ignores that pipeline transport costs have fallen despite the “significant costs” attributed to regulation.
- Note that no incentive for pipelines to reduce regulatory compliance costs they are permitted to be recovered. Need a cap.

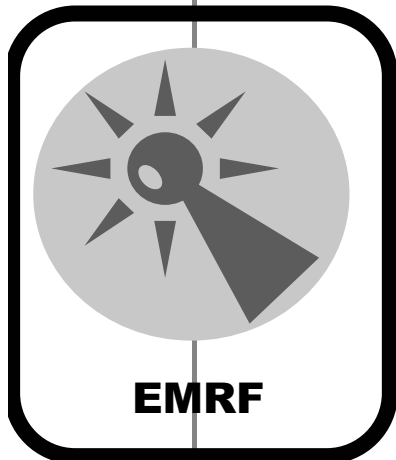


DRAFT RECOMMENDATION 5.2

Draft Report: Delete the objectives in the preamble.

Energy Markets Reform Forum's Response:

- Our concerns are with removing (b) prevents abuse of market power and (d) fair and reasonable right of access.
- Cannot assume monopoly away.
- PC has not established that there is no market power.

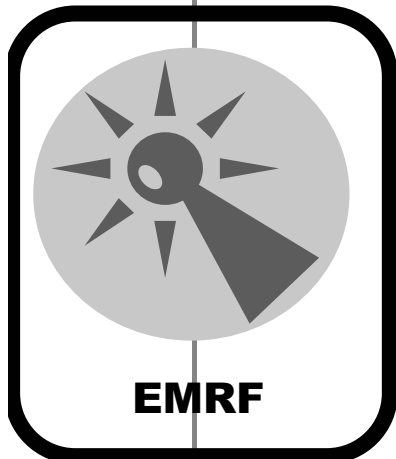


DRAFT RECOMMENDATION 5.3

Draft Report: Delete elements of s.2.24.

Energy Markets Reform Forum's Response:

- Oppose deletion of (f) 'the interests of Users and Prospective Users'.
- If "economically efficient use of, and investment in...pipelines..." is not equated with prices towards short run marginal cost than the elements relating to "the interests of users", "preventing abuse of market power" and "access on fair and reasonable terms must be retained in s.2.24 of the Code and the preamble.

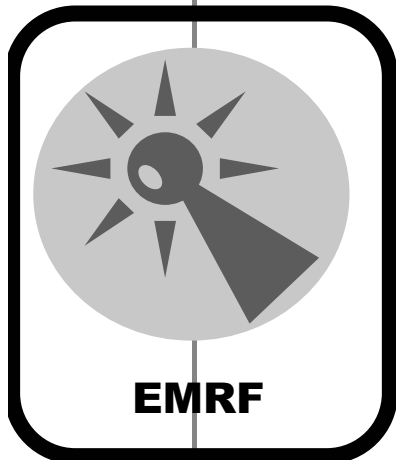


DRAFT RECOMMENDATION 6.6

Draft Report: Substantial and material competition (coverage tests).

Energy Markets Reform Forum's Response:

- This is a major dilution of the Code, based on very little analysis or evidence.
- Legal nightmare and gridlock.
- Tie up NCC and all major pipelines in the Courts.
- A very dangerous and destructive recommendation.

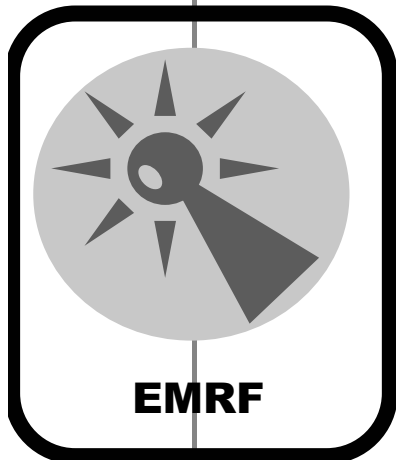


DRAFT RECOMMENDATION 6.7

Draft Report: Monitoring option to apply for 5 years.

Energy Markets Reform Forum's Response:

- Presents major risks for gas users as PC is admitting that monopoly rents do exist.
- What mechanism is provided to extinguish monopoly rents immediately.
- The Airports monitoring example is frightening to gas users.
- Fritter away benefits of the Gas Access Regime.



CONCLUDING REMARKS

- Overall, major gas users strongly consider the Draft Report as fundamentally flawed and its major recommendations likely to reverse the benefits upstream and downstream industries and the pipeline industry have gained from the current Gas Access Regime. They have potential “chilling effects” on investments, both upstream and downstream.
- The Gas Access Regime is working, contrary to the assertions of the Draft Report (which does not provide any evidence to support its claims),
- The market power of the natural monopoly pipeline industry is strongly evident
 - competition is still in its infancy
 - gas market is not mature
 - monopoly power cannot be assumed away.
- Regulation has not deterred or distorted investment in pipelines
 - to the contrary, investments in upstream, mid-stream and downstream industries have been encouraged.
- No rigorous analysis of the key issues asserted by the Draft Report is apparent
 - uncritically accept views put by pipeline industry
 - no cost/benefit analysis undertaken (regulatory decision? NCC coverage decision? Large costs of regulation? Code not working?)
 - no economy – wide analysis presented
 - partial analytical framework.
- Some recommendations are dangerously skewed against consumer interests
 - others present risks of tying up the Courts and the NCC (e.g. proposals concerning substantial and material competition, and monitoring option.
- There are some positives in the Draft Report (e.g. objects clause, appropriately worded)
 - but the negatives of the Draft Report are overwhelming.

