

25th August 2003

Gas Access Regime Inquiry  
Productivity Commission  
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Dear Sirs

### **GAS ACCESS REGIME INQUIRY - ISSUES PAPER**

The Essential Services Commission of South Australia ("ESCOSA") assumed the role of the South Australian local regulator under the *Gas Pipelines Access (South Australia) Act 1997* on 1 July 2003. As such, ESCOSA is a relatively new entrant to the field of gas access regulation and, while it welcomes this review and intends to participate in the review's processes, ESCOSA notes at the outset that it has to date had limited experience with access regulation matters arising under the Gas Access Regime.

As a result, while ESCOSA has heard from various industry parties, both industry participants and other regulators, of problems or difficulties arising from the current form of the Gas Access Regime, ESCOSA is not able, on the basis of experience, to comment in any detail at this stage on practical issues in relation to the regime.

That said, ESCOSA has had significant experience in access regulation in South Australia in relation to maritime services (under the *Maritime Services (Access) Act 2000 (SA)*) and railway infrastructure services (under the *AustraliaAsia Railway (Third Part Access) Act 1999 (SA)*). It would appear to ESCOSA that several of the matters raised for consideration in the Commission's Issues Paper are similar to issues which have been addressed by ESCOSA through its access regulation role for maritime and railway infrastructure services. ESCOSA may, therefore, be able to provide some relevant views on these matters even though, as discussed above, it may not have dealt with them in its capacity as local regulator.

ESCOSA would therefore raise the following issues for consideration in response to the Issues Paper.

### ***Objectives of the Gas Access Regime***

As noted in the Issues Paper, there are a number of objectives posited for the Gas Access Regime, found variously throughout relevant legislation. This issue is, in ESCOSA's view, not one solely confined to the Gas Access Regime, being present throughout other legislative schemes under which ESCOSA has regulatory powers. Nevertheless, ESCOSA would agree that this issue does have the potential to cause regulatory difficulties in terms of ensuring that, from a regulator's point of view, all relevant considerations, and conversely no irrelevant considerations, have been taken into account in reaching a regulatory decision. This difficulty has been compounded by recent Supreme Court decisions (in Western Australia and Victoria) on what a regulator is required to detail in its written decision. ESCOSA would therefore welcome any moves to codify, in a single point of reference, objectives to be applied to the framework for third party access to gas pipelines.

ESCOSA also notes the commentary in the Issues Paper to the effect that certain of the objectives of the Gas Access Regime are ostensibly in conflict. While appreciating that this may be an issue of uncertainty in some circumstances, ESCOSA does not perhaps share the same level of disquiet as other industry participants in respect of this issue, as, in its view, making discretionary "tradeoffs" between such objectives permits a more flexible approach to regulation than might otherwise be the case. Indeed, it is ESCOSA's position that a system permitting a degree of flexibility in approach to regulation is likely to be more beneficial to both the industry and consumers: that is exactly why an independent regulator exists in the first place.

### ***Distinction between distribution and transmission sectors***

It is ESCOSA's understanding at this stage that, in large part, difficulties or disputes in relation to the application of the Gas Access Regime have been in the transmission, rather than distribution, sector of the gas market. If it is incorrect in this understanding, then at the very least it would appear to ESCOSA that there are fundamental characteristics of transmission and distribution networks which are so different as to require different treatments, at least in part.

Certainly, in ESCOSA's regulatory experience in the South Australian electricity supply industry, it has become self-evident that while at a macro level transmission and distribution services are similar, when the two elements are dealt with on an operational regulatory level, significant differences arise. Distribution services are primarily concerned with consumers, whereas transmission services are predominantly the concern of retailers.

This being the case, ESCOSA would support at least an exploration by the Commission of a scheme which might treat these two sectors differently, in part if not in the whole.

### ***Access regulation and new investment***

Following, in part, from the discussion above, it is ESCOSA's view that it is appropriate in access regimes to draw a distinction between existing services and new investments.

As the access regulator for the Tarcoola to Darwin railway service, ESCOSA has recognised this distinction in its preliminary decision setting parameters clarifying the rates of investment return in the event of a dispute between the owners of the Tarcoola to Darwin railway line and users of the service.

In setting these parameters, ESCOSA was mindful of the inherent risks of a greenfields investment of this nature and considered it important that any early regulatory decisions do not interfere with the ability of the operator to set commercially attractive rates and to earn a return commensurate with the risks they have taken. This is particularly the case in greenfields investments where the level of future demand is quite uncertain. It is important in such cases to allow the investor some "blue sky" potential, whilst at the same time protecting consumers from a potential monopoly situation with excessive profits and prices.

The Productivity Commission itself has commented on the negative impact on investment of regulatory decisions which truncate returns (Section 4.3 of the Review of National Access Regime, Report No.17, September 2001). ESCOSA developed an approach to addressing this issue in its regulatory arrangements for the Darwin railway.

ESCOSA believes that consumers' long term interests will best be served by allowing this railway to establish itself as an important and viable transport mode, and then securing attractive and competitive services for the future. This philosophy and approach could be transferable to the greenfields gas transmission regime.

### ***Regulatory Approach***

As a final matter, ESCOSA notes that the broad regulatory process, as embodied in the Gas Access Regime, appears to be of a somewhat inflexible nature. As ESCOSA understands the regime to have operated to date, there has been no opportunity for a more collaborative approach to regulation: a decision to regulate is imposed and the regulated entity has only two choices, to accept the decision or to appeal.

Such an approach is contrary to ESCOSA's regulatory model, which adopts a more flexible collaborative approach to regulation, referred to as the ABC of regulation:

- A** – to achieve the objectives of the Act;
- B** – to balance the regulatory bargain; and
- C** – within a climate of regulatory collaboration.

Element A of this approach has been alluded to earlier in this submission. ESCOSA would therefore refer to the concepts of regulatory bargain and regulatory collaboration.

The concept of a regulatory bargain involves balancing the interests of consumers of a service and the provider of that service; this may perhaps be more conveniently thought of as the service standard provided in return for the price paid. In considering this element of its regulatory approach, ESCOSA is aware of the need to provide a network operator with sufficient incentive to improve operating efficiency, while maintaining (and possibly improving) service standards over time. A key aspect of the regulatory bargain is the provision of a reduction in regulatory risk and uncertainty for the service provider between review periods: it is ESCOSA's view that a regulatory regime with minimal regulatory uncertainty is consistent with a framework that encourages efficient cost outcomes. To achieve this, ESCOSA believes it is important for the regulator to be involved up-front in working with the operator to define the desirable level of service on which the pricing application is based. The Gas Access Regime does not support such an approach.

The regulatory collaboration element of the ABC of regulation involves, as its name implies, a collaborative, rather than adversarial or confrontational, approach to information sharing, dispute resolution, issues identification and planning. This aspect of the regulatory approach is aimed at achieving outcomes, rather than prescribing processes, which are beneficial to all parties. This means jointly exploring, up front, such matters as the level of service, options for delivery and details of access regimes and price structures, rather than responding to proposals in a combative exchange of conflicting reports. The Gas Access Regime appears to encourage delays and disputes.

I trust that these observations are of use to the Commission as it undertakes the review of the Gas Access Regime. As noted earlier, ESCOSA is keen to be involved in the process of this review and to learn from those who have been involved in this area. We will attempt to provide inputs wherever possible, as knowledge and developing experience allows.

Yours sincerely

**Lewis W. Owens**

**CHAIRPERSON**  
**ESSENTIAL SERVICES COMMISSION OF SA**