WMC Resources Ltd

Submission to the Productivity Commission's Inquiry into the National Third Party Access Regime for Natural Gas Pipelines

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Submission to Productivity Commission's Gas Code Review

1. Overview

1.1 WMC's Perspective

WMC Resources Limited ("**WMC**") welcomes the opportunity to provide a submission to the Productivity Commission's ("**Commission**") review of the Gas Access Regime.

WMC is a major user of natural gas and other sources of energy in Queensland, South Australia and Western Australia. WMC uses natural gas delivered directly from gas transmission pipeline systems in Queensland (at the Duchess Phosphate Mine and processing plant through the Carpentaria Pipeline) and in Western Australia (at Leinster, Mt Keith, Kalgoorlie and Kambalda, through the Goldfield Gas Pipeline (**"GGP"**), and at Kwinana through the Dampier to Bunbury Natural Gas Pipeline ("**DBNGP**") and the Parmelia Pipeline). In South Australia WMC uses imported electricity and liquid fuels at its Olympic Dam Project but it has natural gas conversion of these operations under active review.

WMC purchases natural gas on a delivered basis in Queensland and for use at Kwinana in Western Australia, but purchases gas transmission services and natural gas separately for other locations in Western Australia and that gas is transmitted through the GGP. WMC uses gas to produce electricity and steam in both Queensland and Western Australia and as a chemical feedstock in Queensland.

Whereas WMC's gas transportation needs were satisfied by specialist gas industry participants in Kwinana and Queensland, WMC was forced in 1994 to lead a consortium to construct and operate the GGP. WMC's entry into the business of pipeline ownership and operation arose because the terms sought by prospective pipeline developers for the provision of transmission pipeline services were inconsistent with what WMC considered to be a reasonable assessment of the market.

The option to develop the GGP was available to WMC because there were no regulatory restrictions on a party in the position of WMC in relation to constructing a pipeline in these circumstances. It is important that regulatory mechanisms do not restrict a company from having the option of bypassing existing pipelines.

WMC offices in many locations consume relatively small quantities of gas delivered from medium/low pressure gas distribution networks. This gas is often consumed as part of WMC's office leasing arrangements and, in these instances, WMC is not the purchaser of this gas. The comments in this submission, therefore, relate only to WMC's use of natural gas at its major resource development sites and to high pressure gas transmission pipeline systems. No views

are expressed in this submission regarding gas distribution infrastructure or comparisons between gas transmission and gas distribution network infrastructure.

Given its long and active interest in natural gas use and transmission, its consideration of gas conversion at Olympic Dam and its expansion plans at Olympic Dam and Mt Keith, WMC has a strong interest in the maintenance of a Gas Access Regime which:

(a) is fair to users and owners of pipeline systems;

(b) facilitates WMC's need to ensure its international cost competitiveness;

(c) enhances competitive pressure on ex-field gas prices;

(d) encourages the provision of new and extended services; and

(e) allows, ultimately, for WMC to act decisively to provide its own gas supply services when it considers that such action is necessary to address market failure.

WMC has been heavily involved in the processes before the Office of Gas Access Regulation in Western Australia ("**OffGAR**") in relation to both the GGP and the DBNGP, but particularly the GGP, and brings that experience to this submission.

1.2 Structure of submission

This submission discusses a number of issues that WMC believes the Commission should consider in its review of the Gas Access Regime.

Section 2 discusses the objectives of the Code and makes a recommendation for a clear objects clause to be introduced into the Code and Gas Pipelines Access Act.

Section 3 discusses a wide range of process issues, including delay under the Code, Access Arrangement processes, recommendations to reduce delay in the Access Arrangement process, rights of review and coverage issues.

Section 4 deals with access regulations and the development of a competitive market. The section begins by outlining the problems with the current approach and then suggests an alternative focus for setting benchmarks.

Section 5 provides an analysis of pricing mechanisms under the Code.

Section 6 discusses the benefits of the Gas Access Regime to competition in dependent markets generally and then moves to a consideration of the effect that the Gas Access Regime has had on both upstream and downstream markets.

Section 7 deals with the effect that the Gas Access Regime has had on investment in pipelines and investment in downstream markets.

Section 8 discusses coverage issues.

Section 9 discusses the regulatory arrangements under the Gas Access Regime.

1.3 Executive Summary

WMC believes that the Gas Access Regime has an important role to play in enhancing competitive conditions in upstream and downstream markets. WMC is unaware of any instances where the operation of the Gas Access Regime has prevented or delayed investment decisions. The Commission should require precise evidence of any such circumstances before making recommendations which would have the effect of enabling pipeline owners which possess substantial market power from exploiting that power.

WMC has some specific recommendations on the provisions and operation of the Gas Access Regime based on its experience. Those recommendations are that:

(a) an overarching objects clause be included in the Code and Gas Pipelines Access Act that:

The objective of the Gas Access Regime is to promote economically efficient use of, and investment in, gas pipelines.

That objects clause should be specified to be the principle to be accorded primacy in the interpretation of any other provisions in the legislation;

(b) a Final Access Arrangement should take effect either on the date contemplated by contemporaneous legislation or, in the absence of any such legislative intent, on a date determined by the Regulator with provision for repayment and interest payments (to reflect the time value of money) to be made for amounts paid to the Service Provider in excess of the relevant tariff contained in the final Access Arrangement;

(c) revisions to an Access Arrangement should take effect on the date on which the Access Arrangement, to which there are revisions, ceases to have effect;

(d) The roles and operation of sections 38 and 39 of the Gas Pipelines Access Law, recently clarified by the Australian Competition Tribunal in *Application by Epic Energy South Australia Pty Ltd (2003) ATPR 41-932* remain unchanged.

(e) Reference Tariffs should reflect appropriate terms and conditions for third party users and not use terms and conditions of foundation shippers as the benchmark;

(f) additional mechanisms should be introduced to facilitate capacity trading including preventing a Service Provider from restricting the ability of a user to capacity trade;

(g) the efficient costs used in setting the Reference Tariff should be determined having regard to the over riding objective to promote the efficient use of, and investment in gas pipelines;

(h) the Reference Tariff should be set as a third party access tariff with clearly defined parameters and should be set consistent with the overriding objective of achieving efficient investment in, and utilisation of, the relevant pipeline;

(i) open access to transmission pipelines is a fundamental condition to secure competitive upstream gas markets. Any changes proposed to the Gas Access Regime should be tested to ensure that they will not result in limiting the scope for upstream competition;

(j) WMC supports the introduction of binding coverage rulings as proposed by the Council of Australian Governments Energy Market Review;

(k) no changes are required to the coverage criteria; and

(l) there should be separation between the persons making the decision about whether or not a pipeline should be subject to the Gas Access Regime and the persons who make the decisions about the regulatory arrangements once a pipeline is subject to coverage. WMC would not support the two decisions being made by the same body.

2. Objectives of the Code

2.1 The need for an objects clause

As the Commission has said, "Clear specification of objectives is fundamental to all regulation".[1] WMC endorses the comments made by the Commission in this regard in its Review of the National Access Regime.

Given the divergence between the various factors which must be taken into account in the course of the regulatory process, it is becoming increasingly important that there is clear specification of an overall objective which is used as a guide to the hierarchy or priority of objectives otherwise contained in the Gas Access Regime and against which the application of any factors must be considered. In WMC's submission, the primary focus of the Gas Access

[1] Productivity Commission 2001, Review of the National Access Regime, Report no 17, AusInfo, Canberra at p.214

Regime should be the goal of promoting economically efficient use of, and investment in, gas pipelines and it would therefore support the introduction of a clear objects clause to the Code and Gas Pipelines Access Act, consistent with the primary limb of the objects clause proposed by the Commission for Part IIIA.

Recommendation One:
That an overarching objects clause be included in the Code and Gas Pipelines Access Act as follows:
The objective of the Gas Access Regime is to promote economically efficient use of, and investment in, gas pipelines.
Such an overarching objects clause should be specified to be the principle to be accorded primacy in the interpretation of any other provisions in the legislation..

If an overarching objects clause was introduced, the current preamble to the Gas Pipelines Access Act would then be read in that context and need to be consistent with that principle. That should limit any tension which may otherwise be thought to arise from the interaction between various parts of the preamble. The problems which can arise from the lack of a guiding principle are well illustrated in the decision of the Supreme Court of Western Australia in *Re Dr Ken Michael AM; Ex Parte Epic Energy (WA) Nominees Pty Ltd & Anor* [2002] WASCA 231 ("**Epic Energy Case**").

The objects clause should also be used to guide Regulators as to how the principles set out in the preamble should be interpreted. For example, if it were considered appropriate to define benchmark terms which the Regulator might apply to a third party access contract, guidance to this effect could be set out in the preamble.

2.2 Internal consistency in objectives

There are ambiguities between the objects and the provisions of the Gas Pipelines Access Law, the Code and section 8.1 of the Code. These ambiguities and inconsistencies are well illustrated in the Epic Energy Case. There is clearly a need for the Commission, and then legislators, to consider whether the interpretation of the Supreme Court of Western Australia in the Epic Energy Case requires further clarification or modification. In WMC's submission, consideration of this issue needs to take place in the context of this wider review by the Commission of the operation of the Gas Access Regime.

WMC submits that the Epic Energy Case has not satisfactorily resolved the conflict between the Gas Pipelines Access Law, the Code and section 8.1 of the Code. In particular, whilst the Epic Energy Case has questioned the Regulator's interpretation of the Code, it has not provided an alternative interpretation of the Code. The decision has also considered the meaning of economic concepts of "efficiency" and "economic costs" without providing an

adequate alternative interpretation. The decision has revealed a real need to provide guidance as to how the Code should be applied to third parties and the need to provide concrete definitions for imprecise economic language which peppers the Code.

3. Process Issues

3.1 Delays in the Process

One of the major areas of concern in the operation of the Code is the significant delay experienced in the regulatory processes concerning pipeline coverage and revocation and the approval of Access Arrangements.

From WMC's perspective, delay in considering pipeline coverage and revocation has not, to date, significantly affected WMC's business interests. WMC notes, however, that it has been some 9 months since the National Competition Council ("**NCC**") issued its final recommendation to the Hon. Ian Macfarlane MP, Minister for Industry, Tourism and Resources, that coverage of the two pipelines within the Moomba to Sydney Pipeline System ("**MSP**") should not be revoked. Table 3 in Appendix A contains a chronology of events for MSP from the date the proposed Access Arrangement was lodged to date.

WMC's main concern is the delay faced in the finalisation of Access Arrangements.

This concern has been noted by the Western Australian Regulator, Dr Ken Michael, in a paper he presented to the Energy in Western Australia Conference in 2001, Reflections on Gas Access Regulation in Western Australia at p5:

> *"The first point I would like to address is the criticism both in Western Australia and more widely of the timeliness of the regulatory process, particularly in respect of the approval of Access Arrangements.*
>
> *Timeliness is an issue of concern to both myself and obviously for other parties including the providers and users of pipeline services. Throughout states* (sic) *of mainland Australia, the assessment and approval of access arrangement has typically taken well in excess of 12 months to complete. I personally consider this to be unacceptable."*

This section of the submission seeks to identify the sources of delay, the incentives and disincentives created by the Code in relation to delay, and recommends some amendments to the Code to eliminate or reduce the incentives to delay.

3.2 The process for Access Arrangements

Proposed Access Arrangements were submitted to the Regulator for both the DBNGP and the GGP on 15 December 1999. Almost four years later, neither pipeline has an approved Access Arrangement in place.

The regulator has issued his Final Decision in relation to the DBNGP and, after two further extensions of time by the Regulator, Epic Energy now has until 15 October 2003 to submit a revised Access Arrangement to the Regulator. In relation to the GGP, the Regulator is in the process of preparing a revised Draft Decision in relation to the proposed Access Arrangement. It is clear that an approved Access Arrangement is still a significant period of time away.

The significance of these delays is apparent when one considers that the proposed Access Arrangement for the DBNGP provides that the submissions for the revision of the Access Arrangement are due by 1 July 2004. At best, the Access Arrangement for the DBNGP will be operational for a mere six months before it becomes subject to a revision process.

This problem of a fixed finishing date arises because of the requirements of the Code. Section 3.18 of the Code provides:

> *An Access Arrangement Period accepted by the Relevant Regulator may be of any length; however, if the Access Arrangement Period* ***is more than five years****, the Relevant Regulator must not approve the Access Arrangement without considering whether mechanisms should be included to address the risk of forecasts on which the terms of the Access Arrangement were based and approved proving incorrect. These mechanisms may include:*
>
> *(a)* *requiring the Service Provider to submit revisions to the Access Arrangement prior to the Revisions Submission Date if certain events occur, for example:*
>
> *(i)* *if a Service Provider's profits derived from a Covered Pipeline are outside a specified range or if the value of Services reserved in contracts with Users are outside a specified range;*
>
> *(ii)* *if the type or mix of Services changes in a certain way; or*
>
> *(b)* *a Service Provider returning some or all revenue or profits in excess of a certain amount to Users, whether in the form of lower charges or some other form.* (emphasis added)

As a result of this section of the Code, the industry benchmark for the length of a proposed Access Arrangement has become a five year period.

Section 3 of the Code governs the content of an Access Arrangement and, specifically, section 3.17 provides that an Access Arrangement must include a date upon which the Service Provider must submit revisions to the Access Arrangement (a "**Revisions Submission Date**") and a date upon which the next revisions to the Access Arrangement are intended to commence (a "**Revisions Commencement Date**").

By requiring Service Providers to specify a Revisions Submission and Revisions Commencement Date, the term of an Access Arrangement can effectively be set by the Service Provider. Service Providers appear to have generally, although not always, opted to define the term of proposed Access Arrangements in a flexible manner so that regardless of the date on which the Access Arrangement takes effect, it will operate for a period of 5 years.

In WMC's submission it is not in the interests of any party for a lengthy regulatory process to be undertaken and for the results of that process to operate for only a short period of time[2]. It is, however, also important that delays in the acceptance of an Access Arrangement should not be able to be used to delay the commencement of price regulation of a pipeline.

In Western Australia, the DBNGP Access Arrangement states that the Access Arrangement commences on the later of 1 January 2000 or the date the Regulator approves the Access Arrangement. Its Revision Submission and Revision Commencement Dates are fixed dates of 1 July 2004 and 1 January 2005 respectively. This means that there will be only a small time period during which the initial Access Arrangement will apply. The GGP Access Arrangement states that the Access Arrangement Period comes into effect on the Effective Date, which is defined as the date on which the Access Arrangement comes into effect as specified by the Regulator. It has non-specific dates for the Revisions Submission date being four and one-half years after the Effective Date, and for the Revisions Commencement Date being the latter of five years after the Effective Date or when the revised Access Arrangement is approved by the Regulator.

Appendix A contains a brief chronology of events in relation to the proposed Access Arrangements for the GGP and the DBNGP.

The deficiency in the Access Arrangement process is clearly demonstrated when one considers the regulatory environment in which WMC operates. As noted above, the GGP, which is the

[2] It should be recognised that once the Initial Capital Base is set, there are limitations on the changes that can be made to it. Accordingly, it is expected that second and subsequent decisions will be resolved in a quicker timeframe.

main pipeline utilised by WMC, operates without an approved Access Arrangement in place despite the proposed Access Arrangement being submitted to the Regulator almost four years ago. The commercial uncertainty that this sort of delay causes, and the considerable expenditure of time and resources on the regulatory process are issues of real concern to WMC.

3.3 Timeframes under the Code

Section 2.21 of the Code provides that the Regulator must issue a final decision in relation to a proposed Access Arrangement within 6 months of receiving a proposed Access Arrangement. The language of this timeframe is mandatory in the sense that the Regulator must issue a decision within that 6 month period. However, that mandatory timeframe is supplemented by a discretion contained in section 2.22 of the Code which provides that the Regulator may increase the 6 month period by periods of up to two months on one or more occasions. There is no limit to the number of times in which the Regulator may exercise its discretion to increase the 6 month period by 2 month intervals.

In addition, section 7.19 of the Code grants the Regulator further discretion to extend any time period contained in the Code which applies to any person other than the Regulator, the NCC or the Relevant Minister, on any number of occasions, provided that the application for the extension has been received by the Regulator before the expiry of the relevant time period.

The timeframes for each step in the process from draft Access Arrangement to approved Access Arrangement are summarised in Appendix B.

Despite the mandatory language contained in section 2.21, the discretion contained in section 2.22 means that, in practice, the time periods set out in the Code are really no more than guidelines. While WMC understands that Regulators use their best efforts to minimise delays, there is no real mechanism in the Code which Regulators can use to ensure that the time frames contained in the Code are adhered to.

WMC believes that the Regulator's right to draft and impose its own Access Arrangements (in circumstances where it is not satisfied with the Access Arrangements proposed by the Service Provider or in circumstances where the Service Provider fails to respond within the Regulator's time frame) is a less attractive option to a Regulator who is seeking to ensure that Service Providers, access seekers and the Regulator come to a mutually agreeable arrangement. WMC believes that its recommendations contained in sections 3.5 and 3.8 below will assist to redress the delay problems without requiring Regulators to take action to draft and impose their own Access Arrangements.

3.4 Sources of delays in the decision-making process

Set out below are some of the more common matters which can delay the Regulator's decision-making process and determination of a final Access Arrangement. Sections 3.5 and 3.6 then set out suggestions to address delays.

(a) **Regulatory uncertainty –**

One of the issues which has caused significant delay is regulatory uncertainty. This, in part, is a natural function of the introduction of a new system of regulatory arrangements. However, in Western Australia in particular there have been several court proceedings as to the proper approach on questions of law which have delayed the finalisation of Access Arrangements. A number of parties, including the Service Provider, have taken questions of law to the Courts for determination. For example, refer the Epic Energy Case discussed above.

In addition, in December 2001, the owners of the GGP commenced proceedings in the Supreme Court of Western Australia against the Western Australian Regulator and the State of Western Australia seeking, inter alia, declarations in relation to the interaction between the Code and the State Agreement ratified by the *Goldfields Gas Pipeline Agreement Act* 1994 (WA) (**"State Agreement"**). This action was discontinued by the GGP owners in November 2002.

Further, WMC has recently instituted proceedings in the Supreme Court of Western Australia to determine a question of law arising from the methodology the Regulator proposes to apply in considering the proposed Access Arrangement for the GGP, specifically the Regulator's proposed approach to considering the effect of the State Agreement.

WMC accepts that such cases are inevitable in relation to regulation in a relatively new regulatory environment. WMC does not propose any amendment to the Code on this issue, and it would not consider it appropriate for review mechanisms and prerogative type proceedings to be circumscribed by the terms of the Code.

(b) **Lack of incentives to Service Providers to expedite the Access Arrangement Process.**

Under section 2.26, the final Access Arrangement has effect from a date not less than 14 days from the date of the Regulator's decision. Accordingly, an Access Arrangement is not operative during the time when it is under consideration by the relevant Regulator. Thus, the terms and conditions of access during this period are effectively unregulated. It seems inconsistent with the objectives of the Code for

there to be lengthy periods during which access terms and conditions are effectively unregulated, yet this is precisely what has occurred for the initial Access Arrangements for the DBNGP and GGP in Western Australia.

In WMC's submission, it would be consistent with the intent of the Code to provide a mechanism by which an approved Access Arrangement takes effect at an earlier time. It seems clear that it was anticipated that the regulatory processes under the Code would be completed far more expeditiously than has, in fact, occurred. This can be seen, by way of example, in ss 93 & 97 of the *WA Gas Pipelines Access Act*, which provided for regulatory mechanisms which were in existence prior to the Code to remain in existence as deemed approved Access Arrangements under the Code until 1 January 2000. This suggests that it was intended that approved Access Arrangements under the Code would be in force by 1 January 2000. It is not appropriate that users are penalised by delays in the approval of Access Arrangements and a mechanism should be devised to ensure that an Approved Access Arrangement takes effect either on the date contemplated by the legislature when the arrangements were established or a date determined by the Regulator.

(c) **Wide discretionary powers to the Regulator to grant time extensions**

While the Code contains a mandatory timeframe of 6 months from the date of receipt of a proposed Access Arrangement to the date of the Regulator's final Access Arrangement, that mandatory timeframe is subject to Regulators' wide discretionary powers to grant an unlimited number of extensions.

WMC recognises that, in some circumstances, there may be a legitimate need for the Regulator to grant extensions of time, either for Service Providers and third parties to make submissions or for the Regulator itself to consider submissions, consider a draft Access Arrangement or to finalise its determination.

However, WMC believes that some limits should be placed on the number of extensions and circumstances in which extensions of time should be granted by the Regulator. This is discussed further in sections 3.8 to 3.11 below.

(d) **Merits appeal and appeals on questions of law**

Applications to appeal bodies are another source of delay. A current example is the application by Epic Energy South Australia Pty Ltd ("**Epic**") to the Australian Competition Tribunal for a review of the decision of the ACCC to draft and approve an Access Arrangement for the Moomba to Adelaide Pipeline System pursuant to section 2.20(a) of the Code.

The proposed Access Arrangement was originally submitted by Epic to the ACCC on 1 April 1999. On 31 July 2002, the ACCC gave final approval to an Access Arrangement drafted and approved by it (some 2 years and two months after the proposed Access Arrangement was first lodged). On 14 August 2002, Epic filed an application with the Australian Competition Tribunal for a review of the ACCC's decision. Epic's substantive claim was heard in the Australian Competition Tribunal during the week beginning 18 August 2003. The parties are awaiting the decision.

One possible option to limit the delay caused by such appeals is to limit the appeal right to questions of law only. Such a limitation was imposed under Part XIC of the *Trade Practices Act 1974* ("**TPA**") in relation to appeals by parties to a final determination under the telecommunications access regime. WMC would not support more limited rights of review being placed upon parties entitled to seek review under Section 39 of the Gas Pipeline Access Law. In WMC's submission, the emphasis should be on eliminating the benefits to Service Providers of delaying the application of the proposed Access Arrangements and expediting review and appeal processes rather than on limiting those processes.

WMC believes that the current appeal provisions contained in the Gas Pipelines Access Law, which have recently been clarified by a decision of the Australian Competition Tribunal on an interlocutory matter in the Epic review application, are appropriate. The effect of those provisions is that for a change made to an Access Arrangement by a Regulator, there is an entitlement to a review on any of the following bases:

(a) an error in the Regulator's findings of fact;

(b) that the exercise of the Regulator's discretion was incorrect or was unreasonable having regard to all the circumstances; or

(c) that the occasion for exercising the discretion did not arise.

The relevant appeals body is limited in the material to which it may have regard in conducting a review under Section 39 of the Gas Pipelines Access Law so that, essentially, it is review on the papers before the relevant Regulator. The scope of this review has been described by the Australian Competition Tribunal in the following way:

"*The power to review under s39(1), although involving a rehearing on the merits, ought to be construed as one to be exercised for the correction of error*"[3]

For decisions other than those specified in s39, i.e. decisions other than a Regulator's amendments to an Access Arrangement, full merits review applies under s38 of the Gas Pipelines Access Law.

This issue is discussed further in section 3.13 below.

3.5 Recommendations to reduce delay in reaching a final Access Arrangement

Recommendations Two to Four: Date on which Access Arrangement takes effect

Recommendation Two: A Final Access Arrangement should take effect either on the date contemplated by contemporaneous legislation or, in the absence of any such legislative intent, on a date determined by the Regulator with provision for repayment and interest payments (to reflect the time value of money) to be made for amounts paid to the Service Provider in excess of the relevant tariff contained in the final Access Arrangement.

In WMC's submission, there are three situations which need to be considered. First, the date on which initial Access Arrangements for covered pipelines take effect. Secondly, the date on which initial Access Arrangements for pipelines not currently covered but which are subsequently covered, whether new or existing pipelines which have become subject to coverage, take effect. Thirdly, the date on which revisions to Access Arrangements take effect.

In WMC's submission, it is clear that the policy intent behind the Gas Code was that pipelines subject to coverage would have Access Arrangements put in place and approved within a relatively short time frame. This is reflected in section 2.21 of the Code referred to in section 3.3 of this submission. It was on this basis that the DBNGP, GGP, the Alinta Gas Midwest and Southwest Gas Distribution Systems were derogated to have their existing access regime deemed to comply with the Code until 31 December 1999. In WMC's submission, this evinces a clear intention, well known to pipeline owners and operators, that the Access Arrangements were intended to apply, at least in Western Australia, from 1 January 2000. In WMC's submission, the Gas Access Code should require that Access Arrangements for schedule A pipelines apply from 1 January 2000 with provision for repayment and interest payments to

[3] Application by Epic Energy South Australia Pty Ltd [2002] ACompT 4

reflect the time value of money for amounts paid to the service provider in excess of the relevant tariff contained in the final Access Arrangement.

The situation is somewhat different for pipelines which were not included in the initial list of covered pipelines either because they were not in existence at the time or because it was not considered appropriate that they be covered at that time. The formulation of the recommendation proposed by WMC recognises the fact that there are some circumstances, eg for pipelines not originally contemplated to be covered by the Code, where there should be a discretion as to the date on which the Access Arrangement takes effect. The granting of such a discretion to the Regulator would enable him to set the effective date as the date of submission of the Access Arrangement. This would operate to provide the Service Provider with an incentive to seek to resolve Access Arrangements as quickly as possible given that, once approved, it will take effect from a date prior to approval.

Given the nature of contractual arrangements for gas transmission services, WMC does not anticipate that there will be significant practical difficulties in keeping appropriate records, which would enable a Service Provider to determine charges made in excess of that subsequently approved under the Access Arrangement, for the relevant period.

Recommendation Three: Revisions to an Access Arrangement should take effect on the date on which the Access Arrangement, to which there are revisions, ceases to have effect.

This is designed to ensure that there is no gap in the period applicable to an Access Arrangement. If Access Arrangements are structured such as the GGP Access Arrangement which provides the Revisions Commencement Date is the latter of 5 years after the commencement or when the revised Access Arrangement is approved by the Regulator, there is scope to delay the intended revision and replacement of regulatory arrangements. It seems inconsistent with the overall policy intent that any such delay be permitted. Discretion in the Gas Access Regime

For Access Arrangements where, under the mechanism proposed in section 3.5, the Regulator has a discretion as to the date on which an Access Arrangement will take effect, it is important to examine the factors which can and should properly be taken into account by the Regulator in the exercise of that discretion.

A proposed Access Arrangement, submitted by a Service Provider, operates in a manner similar to an access undertaking under Part IIIA, in that it outlines the terms and conditions that the provider is prepared to offer third party users at that time. This proposed Access Arrangement operates, in effect, as an offer to third party users to acquire the services on the same terms and conditions as those in the proposed Access Arrangement. While not expressed as a mandatory right of access, the Code operates, in effect, to give users a right to access the

pipeline at the time a proposed Access Arrangement is submitted, on the terms and conditions provided in that proposal.

Like Part IIIA, there are also circumstances under the Code where the submission and consideration of proposed Access Arrangements will affect users who already have access to the pipeline.

In the Commission's review of the National Access Regime, it expressed some concerns about backdating regulatory decisions[4]. This concern appears to have arisen from practical difficulties which may arise under the Part IIIA mechanisms where the access seeker does not currently have access to the relevant service. In its report in the Telecommunication Competition Regulatory Inquiry, the Commission saw a role for backdating given the mandatory nature of the Access Arrangements which arise once a telecommunications service has been declared under Part XIC[5].

Under the Gas Code, the concerns about a lack of, or right to, mandatory access do not apply. For those parties who do not have access at the time a proposed Access Arrangement is submitted to the regulator, the operation of the Code and the very requirement to submit a proposed Access Arrangement nullifies these concerns. For those parties who do have access, concerns over mandatory rights of access are not applicable. Indeed, the fact of submission of Access Arrangements and the nature of those Access Arrangements, suggest that the case for backdating is clearer in the Gas Code than in any of the other access regimes which the Commission has considered.

The introduction of a backdating mechanism is not punitive, rather it is designed to create incentives on the Service Provider and service users. Gas transmission pipelines exhibit natural monopoly characteristics and, absent regulation, pipeline owners have the ability to earn monopoly rents. Currently, regulation by way of Access Arrangement is not binding on the Service Provider until the Access Arrangement is finalised. Absent a back-dating mechanism, there is no incentive on the part of the Service Provider either to propose an Access Arrangement containing tariff pricing that is consistent with the likely regulated outcome or to expedite the finalisation of the Access Arrangement. Where backdating is not permitted, Service Providers have an incentive to set high prices in proposed Access Arrangements. Any gains made by the provider in setting access prices artificially high are retained by the provider. Service Providers therefore have an incentive to delay the regulatory process for as long as possible and retain the benefits of high access prices. These incentives run contrary to the objectives of the Code.

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[4] Productivity Commission 2001, Review of the National Access Regime, Report no 17, AusInfo, Canberra at p.215

[5] Productivity Commission 2001, Telecommunication Competition Regulatory Inquiry, AusInfo, Canberra at 355

As the Code currently operates, providers have an incentive to delay the process by which the Regulator comes to a final decision on the proposed Access Arrangement. If the date on which an Access Arrangements would come into force was fixed consistent with the legislative policy intent, it would shift the incentives facing a Service Provider. In these circumstances, there would be a greater incentive on the Service Provider to make the terms and conditions provided in the proposed Access Arrangement close to the expected regulated outcome.

WMC therefore recognises that the cost to parties is not the only impact of delay in the approval of an Access Arrangement. There are other terms and conditions of an Access Arrangement, in addition to price, which may be impacted if an Access Arrangement is goven retrospective effect. However, for the reasons outlined above, those other factors would not create an insurmountable obstacle to WMC's recommendation to give retrospective effect to an Access Arrangement. In addition, in WMC's proposal, the decision to give retrospective effect to an arrangement for non-Schedule A pipelines would be at the discretion of the Regulator who would be in a position to consider all relevant terms and conditions in determining whether or not the backdate an Access Arrangement.

3.6 Discretion in the Gas Access Regime

For Access Arrangements where, under the mechanism proposed in section 3.5, the Regulator has a discretion as to the date on which an Access Arrangement will take effect, it is important to examine the factors which can and should properly be taken into account by the Regulator in the exercise of that discretion.

A proposed Access Arrangement, submitted by a Service Provider, operates in a manner similar to an access undertaking under Part IIIA, in that it outlines the terms and conditions that the provider is prepared to offer third party users at that time. This proposed Access Arrangement operates, in effect, as an offer to third party users to acquire the services on the same terms and conditions as those in the proposed Access Arrangement. While not expressed as a mandatory right of access, the Code operates, in effect, to give users a right to access the pipeline at the time a proposed Access Arrangement is submitted, on the terms and conditions provided in that proposal.

Like Part IIIA, there are also circumstances under the Code where the submission and consideration of proposed Access Arrangements will affect users who already have access to the pipeline.

In the Commission's review of the National Access Regime, it expressed some concerns about backdating regulatory decisions[6]. This concern appears to have arisen from practical

[6] Productivity Commission 2001, Review of the National Access Regime, Report no 17, AusInfo, Canberra at p.215

difficulties which may arise under the Part IIIA mechanisms where the access seeker does not currently have access to the relevant service. In its report in the Telecommunication Competition Regulatory Inquiry, the Commission saw a role for backdating given the mandatory nature of the access arrangements which arise once a telecommunications service has been declared under Part XIC[7].

Under the Gas Code, the concerns about a lack of, or right to, mandatory access do not apply. For those parties who do not have access at the time a proposed Access Arrangement is submitted to the regulator, the operation of the Code and the very requirement to submit a proposed Access Arrangement nullifies these concerns. For those parties who do have access, concerns over mandatory rights of access are not applicable. Indeed, the fact of submission of Access Arrangements and the nature of those Access Arrangements, suggest that the case for backdating is clearer in the Gas Code than in any of the other access regimes which the Commission has considered.

The introduction of a backdating mechanism is not punitive, rather it is designed to create incentives on the Service Provider and service users. Gas transmission pipelines exhibit natural monopoly characteristics and, absent regulation, pipeline owners have the ability to earn monopoly rents. Currently, regulation by way of Access Arrangement is not binding on the Service Provider until the Access Arrangement is finalised. Absent a back-dating mechanism, there is no incentive on the part of the Service Provider either to propose an Access Arrangement containing tariff pricing that is consistent with the likely regulated outcome or to expedite the finalisation of the Access Arrangement. Where backdating is not permitted, Service Providers have an incentive to set high prices in proposed Access Arrangements. Any gains made by the provider in setting access prices artificially high are retained by the provider. Service Providers therefore have an incentive to delay the regulatory process for as long as possible and retain the benefits of high access prices. These incentives run contrary to the objectives of the Code.

As the Code currently operates, providers have an incentive to delay the process by which the Regulator comes to a final decision on the proposed Access Arrangement. If the date on which an Access Arrangements would come into force was fixed consistent with the legislative policy intent, it would shift the incentives facing a Service Provider. In these circumstances, there would be a greater incentive on the Service Provider to make the terms and conditions provided in the proposed Access Arrangement close to the expected regulated outcome.

[7] Productivity Commission 2001, Telecommunication Competition Regulatory Inquiry, AusInfo, Canberra at 355

3.7 Concluding remarks

The current arrangements by which an Access Arrangement can, by its own terms, not come into force until after it has been accepted, is not consistent with the intent of the Code which was for Access Arrangements to be in place at a much earlier stage and, at least in Western Australia, from 1 January 2000. In WMC's submission it is important that mechanisms be introduced into the Code to ensure that neither Service Providers nor users have no incentive to delay the Access Arrangement process. The recommendations which WMC has made would achieve this.

The rationale behind the recommendations which WMC has made is consistent with the comments made by the Commission in its Review of the National Access Regime.[8] The mechanisms under the Code are somewhat different from the general provisions of Part IIIA of the TPA in that Part IIIA is directed at bilateral outcomes arising from negotiation and arbitration where negotiation fails whereas, whilst the Code provides for negotiation, it also has a mechanism effectively for mandatory access under the Access Arrangement. In substance, however, the incentives and the need for an incentive to facilitate speedy resolution of the terms and conditions of access, whether by way of negotiated or arbitrated outcome, or an accepted Access Arrangement, are the same.

Finally, WMC recommends the adoption of interest payments to compensate for the time value of money.

[8] Inquiry Report at p213

3.8 Recommendation Four: Limitations on extensions of time

Recommendation Four: The Regulator's discretion to extend time periods under section 2.22 and 7.19 should be limited by:

(a) enabling the Regulator to extend twice on any grounds;

(b) requiring any further extensions to be limited to circumstances where there is new information that would have a material effect on the Regulator's decision.

(c) requiring the person providing any new information to verify by statutory declaration that the new information was not known nor was it reasonably available to the party submitting it at the time submissions closed;

(c) requiring the Regulator, for any time extension granted pursuant to paragraph (b), to publish reasons for granting the extension and those reasons would be subject to judicial review.

In WMC's submission, a recommendation of the type proposed above, coupled with the specification of the date from which the Access Arrangement takes effect, will create the best incentives for parties to deal with Access Arrangements promptly.

If, however, the Commission is not minded to support this approach, an alternate approach would be for an absolute time limit to be set upon a Regulator's decision on an Access Arrangement. Given the breadth of the rights of review which are available in relation to a Regulator's decision in relation to an Access Arrangement, in WMC's submission such a time limit would not materially prejudice any party's rights and would assist the Regulator in managing the time frame for submissions. It seems to WMC that the current structure does not provide the Regulator with sufficient mechanisms to impose strict time lines on Service Providers and interested parties. Where all parties to a process know that the Regulator has an unlimited ability to extend time, the incentives and scope for delayed processes are significantly increased. An approach of this type would retain a sufficient level of flexibility for the Regulator but, importantly, would impose timing disciplines.

Alternative recommendation: The Regulator may only grant extensions of time such that the maximum period within which an approved Access Arrangement must come into place is two years after the date on which the proposed Access Arrangement was scheduled to take effect.

3.9 Limiting the Regulator's discretion

To date, experience has shown that the time periods established in the Code are rarely adhered to by the Regulators. WMC believes that this fact is partly attributable to the Regulator's wide discretion to extend time periods without having to give reasons for that extension. WMC does not dispute that there are legitimate reasons for increasing the time periods for determining final Access Arrangements. Accordingly, WMC proposes that the Regulator's

discretion is limited to those circumstances which justify extensions. In this way, the Regulator has a "tool", in addition to its ability to draft and approve its own Access Arrangement or revisions to an Access Arrangement, which it can utilise to reduce delay in finalising Access Arrangements and to enforce the time periods contained in the Code.

3.10 Statutory declaration to accompany application for extension

WMC recommends that where a Service Provider or other interested party has submitted new information has come to light which will impact on the Regulator's decision after the time the Regulator had specified in its request for submissions as the closing date for such submissions, the Service Provider or other interested party must submit a statutory declaration from a senior executive declaring:

(a) that the new information was not known nor reasonably available to that person for submission to the Regulator by the closing date specified by the Regulator for public submissions on the proposed Access Arrangement; and

(b) that the new information will materially affect the Regulator's decision.

Requiring the Service Provider or other interested party to submit a statutory declaration in those terms forces that person to reflect carefully on the nature of the information sought to be considered by the Regulator. WMC anticipates that this requirement will act as a deterrent to persons seeking extensions of time in relation to information which will not materially affect the Regulator's decision-making process.

3.11 Reasons for decision

(a) **Increased accountability**

One policy impetus behind WMC's recommendation that the Regulator publish its reasons for granting extensions of time is to create an environment of greater accountability. Requiring the Regulator to publish reasons for its decision may encourage Regulators to reflect more carefully on the necessity to extend. In the longer term, the publication of reasons will likely create a body of policy which will enable applicants for time extensions and persons affected by delayed finalisation of an Access Arrangement greater certainty as to the matters which will and will not constitute a sufficient basis to delay.

(b) **Increased transparency**

The Regulator's discretion to grant time extensions pursuant to section 2.22 and 7.19 is very wide. Such a wide discretion to extend time periods without the requirement of publishing reasons runs counter to the mandatory time periods set out in section 2.21. The proposed requirement for the Regulator to publish its reasons can be seen as satisfying the requirement of general due process. The Regulator's decision-making is therefore more transparent and the persons affected by the decision have the opportunity to examine the reasons to satisfy themselves as to the justification or otherwise of the decision. This in turn should promote public confidence.

(c) **Judicial review**

There would be little utility in requiring Regulators to publish their reasons for decisions if there was not also a right to a review of those decisions. By exposing the material factual bases on which a Regulator's decision was based, persons affected by the decision can determine whether or not to challenge the Regulator's decision. In addition, the relevant appeals body (or the judiciary) will be assisted in determining any dispute referred to it by the statement of reasons.

3.12 Concluding remarks

WMC submits that the combination of recommendations made above, including time limitations, statutory declarations and the requirement of giving reasons for the extension of time to consider an Access Arrangement and judicial review of these decisions, gives the Regulator greater power, and parties a greater focus, to ensure the regulatory process proceeds in a timely manner. WMC submits that the recommendations retain sufficient flexibility to ensure that legitimate causes for delay can be accommodated.

3.13 Recommendation Five: Rights of review

Recommendation Five:

That the roles and operation of sections 38 and 39 of the Gas Pipelines Access Law, recently clarified by the Australian Competition Tribunal in *Application by Epic Energy South Australia Pty Ltd (2003) ATPR 41-932* remain unchanged.

The current rights of review provide for what are, in substance, merits reviews and, to the extent that those are limited in certain ways, WMC considers such limitations appropriate.

The Code at section 2.26 envisages that a decision by a Regulator pursuant to sections 2.20(a) or 2.23 (a decision by a Regulator to draft and approve its own Access Arrangement), is

subject to review. Sections 38 and 39 of the Gas Pipelines Access (South Australia) Law detail the relevant appeal and review mechanisms.

Section 39 of the Gas Pipelines Access (South Australia) Law provides that in considering an application for a review of a Regulator's decision to:

(a) draft and approve an Access Arrangement; or

(b) draft and approve revisions submitted for approval by a Service Provider or to draft revisions where the Service Provider fails to submit an Access Arrangements or where revisions required by the Code,

the Service Provider or a person who made a submission to the relevant Regulator, whose interests are adversely affected by the Regulator's decision may make an application for a review of that decision.

Such an application may be made on the following grounds:

(a) that the Regulator made an error in its findings of fact; and

(b) the Regulator's discretion was incorrect or unreasonable or did not arise.

A matter that was not raised in submission to the Regulator may not be relied upon in that review.

Section 38 is not so limited in relation to the grounds for review or the matters that can be considered by the appeals body.

Epic, in its application to the Australian Competition Tribunal for a review of the ACCC's decision under section 2.20(a) to draft and approve its own Access Arrangement, sought to ground its application in section 38 rather than section 39 so that that application would not be subject to the limitations of section 39 reviews.

In its decision on this interlocutory matter, the Australian Competition Tribunal held that an application for a review of a decision made under section 2.20(a) and 2.23 is reviewable pursuant to section 39 of the Gas Pipelines Access (South Australia) Law. It stated at [15]:

> " *15 The GPA Law draws a distinction between reviews conducted under s 38 of that Law and those conducted under s 39. The relationship between the two sections is limited. Each provides for a discreet right of review. Section 38 has no application to a review under s 39, other than to the extent that s 39 expressly makes applicable by reference various subsections of s 38 (other than subsections (1) and (13)) and then only "[e]xcept as otherwise provided in this section": s 39(6). Additionally, the right to such a review under s 39(1) is limited to the*

Service Provider (s 39(1)(c)), and to persons who made a submission to the relevant Regulator on the access arrangement and whose interests are adversely affected by the decision (s 39(1)(d)). It is clearly the legislative intention to confine the right of review under s 39(1) to those who participated in the process, as the Service Provider, or as a person making a submission, which led to the decision under s 2.20(a) of the Code. The intention to exclude persons generally from seeking a review, even if adversely affected by the decision, is important when it is noted that the grounds upon which review may be granted are limited and do not allow recourse to matters not raised in submissions to the relevant Regulator: see s 39(2)(b) and s 39(5)(a)."

In addition, the Australian Competition Tribunal held, at [18], that a section 39(1) review does not operate to stay the Regulator's decision.

The provisions of section 39 enable a review to go beyond what would be considered a judicial review. Specifically, errors on findings of fact are subject to review. Accordingly, the nature of a review of an Access Arrangement is that of a merits based review as described by the Tribunal. The review under s39 is, however, what is often described as a "review on the papers" in that it is a review in which the relevant appeals body considers the material specifically set out in s39(5) and on that basis must make its decision. If one examines the material available to the relevant appeals body, they are in substance:

(a) the application for review and submissions made in support of the application;

(b) the relevant Access Arrangement; and

(c) submissions made to and decisions made by the relevant Regulator including transcripts of any hearing conducted by the Regulator.

Confining the scope of the material to which the relevant appeals body may have regard limits the scope of the appeal so that parties, whether Service Providers or interested parties, cannot hold back material until the review process but must provide full material to the relevant Regulator. By doing this, WMC considers that it enables proper articulation of the issues before the relevant Regulator and that, in itself, it is likely to lead to the Regulator being well placed to make a decision.

3.14 Concluding Remarks

WMC considers that, in relation to appeals from decisions of the Regulator under sections 2.20(a) and 2.23 of the Code, the appropriate balance has been struck between:

(a) seeking to limit the delay caused by merits review of decisions; and

(b) affording persons aggrieved by a decision of the Regulator, natural justice.

Together with:

(a) WMC's recommendation to give the Regulator a discretion to give effect to a final Access Arrangement effective from the date on which the proposed Access Arrangement was scheduled to take effect (with provision for repayment and interest payments to be made to the relevant parties);

(b) the Australian Competition Tribunal's decision as to the proper basis for a review of the Regulator's decision under sections 2.20(a) and 2.23;

(c) WMC's recommendation that appeals from decisions of the Regulator as to extensions of time be limited to judicial review; and

(d) the Australian Competition Tribunal's decision that a review under section 39(1) does not operate to stay the Regulator's decision,

WMC is satisfied that these recommendations will reduce the incentive on the part of Service Providers to unduly delay or protract the process of determining Access Arrangements.

3.15 Coverage Issues

Delayed determinations on applications for coverage and revocation of coverage generate some uncertainty for the business activities of gas users. The NCC's recommendation to the NSW Minister not to revoke coverage of the MSP was issued on 14 November 2002. Section 1.13 of the Code provides that the Minister must make a decision that the MSP is covered or is not covered within 21 days of receiving the NCC's recommendation. The Minister's decision has not been issued, some 9 months after the NCC's recommendation was made.

In addition, WMC has made submissions to the NCC in relation to the application for revocation of coverage of the GGP. The NCC has recently extended the time for the publication of its draft recommendation to 4 September 2003.

However, such delays have, to date had less of an impact on WMC's business activities than have delays in finalising Access Arrangements.

For consistency with the Access Arrangement process, WMC suggests that the Commission recommends the creation of a regime similar to that outlined in Recommendation Three above in relation to extensions of time in the coverage/revocation of coverage decision making process.

4. Access Regulation and the Development of a Competitive Market

4.1 The "Third Party" Benchmark

The broad objectives of the Gas Access Regime are to provide a framework in which:

(e) Service Providers and users would be able to negotiate mutually acceptable gas transportation arrangements;

(f) access benchmarks would be established to limit exploitation of substantial market power by Service Providers; and

(g) access disputes would be resolved, after consideration of the negotiations between the parties and the pre-existing benchmarks, by an independent arbitrator when users and Service Providers are unable to agree negotiated access terms.

The Gas Access Regime is therefore based upon a market model which comprises:

(a) “first parties” - the Service Provider;

(b) “second parties” - foundation shippers who, by way of their contract undertakings, facilitate initial (and large incremental) investments in pipelines, referred to as “anchor loads” and “foundation shippers”; and

(c) “third parties” - those parties who seek access to pipeline services but either:

(i) were not on the scene when the initial (and/or major incremental) pipeline investments took place; or

(ii) were in existence at that time but did not participate in initial pipeline investment through foundation contracts.

The Gas Access Regime is intended primarily to be focused on the needs of “third party” users of gas transmission services. To properly administer the Gas Access Regime it would appear appropriate to begin by defining the service terms which might reasonably be applied to these third parties and then to establish a fair and reasonable price for that service.

The emphasis in precedents produced under the Gas Access Regime, however, appears to be based on defining the terms on which a foundation shipper should expect to access pipeline services. These terms have then been determined as applicable to third party pipeline users, meaning that third parties are assumed to require long term contracts with substantial take or pay components, extensive credit support and tariffs based upon highly secured cash flows. In essence, third parties have been considered to both want and to warrant commercial terms

which are equivalent to those accepted by foundation shippers and which are capable of being used to underwrite major pipeline investments.

The regulatory decisions under the Gas Access Regime do not appear to recognise that gas transmission contracts, as is the case with other contracts such as rail haulage contracts, involve a premium being paid by users for short term and flexible contracts. In WMC's submission, this has lead to an increasing tendency to use the Gas Access Regime to fix prices for access along the lines of the Prices Surveillance Act in its first incarnation. The access prices and terms set by regulators as Reference Tariffs have not facilitated negotiated outcomes and have simply become the price on offer for the relevant services. In WMC's submission, this approach does not satisfy the objects of the regime and is inconsistent with achieving light-handed regulation which properly affects the incentives to invest.

4.2 Alternate Focus for setting the benchmarks

There are now at least two Access Arrangements available which have resulted from the public tender model set out in the Code. These Access Arrangements relate to the East Gippsland and Mildura gas pipeline networks and contain competitively determined rates of return and investment and access terms for the relevant systems.

Importantly, the rates of return and access terms described in these Access Arrangements do not necessarily apply to "anchor loads" on the respective pipeline systems but they apply to those parties who seek access on a flexible or even casual basis. That is to say, these rates of return and access terms relate to third party access. Clearly, there is room in these rates for the Service Provider to seek out anchor loads and to negotiate alternative prices and terms in return for volume, contact duration and, or, credit or cash flow enhancement agreed by negotiation.

These Access Arrangements therefore provide a benchmark for defining the terms of a third party access contract. The terms include, amongst other things, that the third party contract will be relatively short term or even provide for casual use of the pipeline, relate to relative small service volumes, may contain minimum payment obligations but only for the relatively short term of the arrangement, provide for evergreen rights of access, may contain some credit support but this would not extend to providing investment underwriting, has limited exposure to liability in the case of non-performance by the Service Provider. These third party terms can be considered analogous to those confronting domestic and commercial users of gas on gas distribution networks.

Similarly, these Access Arrangements provide a competitively determined rate of return model at a point in time when financial market setting can be determined. Thus, they provide a model which can be updated and applied to set third party tariffs. Further, the definition of third party terms, and rates of return provided by these Access Arrangements can be updated

as Access Arrangements are developed for new pipeline infrastructure when the public tender provisions of the Code are used.

A key element of such an alternative benchmark would be the notion of "evergreen" access rights such that the access entitlement endures but the terms and conditions will be the prevailing terms and conditions at the relevant time.

Care needs to be taken, when applying this third party focused access arrangement model to access disputes regarding pipeline expansions and extensions, to recognise that the third party access terms may be inadequate to justify, or support, any necessary expansion of pipeline capacity. In that case the Regulator would need to resolve the value of (and even require) concessions regarding the terms of access by the anchor load and the Service Provider so as to facilitate the necessary investment. It would not be appropriate, as at present, to simply require the Service Provider to make the necessary investments on the third party access terms set out in the Access Arrangement. However, the current protections afforded the Service Provider in regard to forced capacity expansions could be reconfigured to provide the necessary safeguards.

4.3 The role of negotiations

Recommendation Six: Reference tariffs should reflect appropriate terms and conditions for third party users and not use terms and conditions of foundation shippers as the benchmark.

It appears that, as a general rule, the access terms prescribed in existing Access Arrangements have become de facto access terms for all pipeline users. Perhaps this has arisen because:

(a) Service Providers are unwilling to make price concessions and service seekers have little capacity to improve the quality of their payment stream given the terms of access set out in approved Access Arrangements; and

(b) users' price expectations are established by the Access Arrangement and agreement cannot be reached on the value of more flexible supply arrangements.

It would be an error to suggest that Regulators are solely responsible for this situation. Service Providers and regulators alike initially appeared to focus upon providing third party access under terms and conditions akin to foundation contract terms. By so doing, the regulated tariff precedents appear to have led Service Providers to seek more restrictive access terms and so the tendency compounds.

If the terms of third party access were defined, insofar as contract duration, contract quantity, load factor, security, etc were defined to suit the needs of a non-foundation shipper, then negotiation of access terms and tariffs would become a real option.

Based on its experience, WMC believes that if the Reference Tariff is set as a genuine third party reference tariff on the basis described above, it is far more likely that parties will successfully negotiate transmission arrangements using that as a benchmark but with variations to take into account the characteristics of the customer, the customer's demand and the quality of the revenue stream offered by the customer.

4.4 The role of capacity trading

Recommendation Seven: Additional mechanisms should be considered which facilitate capacity trading and limit over contracting designed to damage competition, including mechanisms which encourage a Service Provider to foster the capacity trading.

Capacity trading plays an important part of the Code because, amongst other things, it:

(a) limits the extent to which Service Providers may double sell capacity under take or pay contracts when the Service Provider becomes aware that a shipper is unable to use its capacity;

(b) allows a shipper to mitigate the cost of unexpectedly not being able to use its full capacity rights; and

(b) allows a shipper to reserve pipeline capacity ahead of need (as may be required to secure investment/debt commitments) and to mitigate the cost of that reservation in the first instance.

From the perspective of the shipper, the right to trade capacity is an important part of risk management. From the market's point of view, shippers who trade surplus pipeline capacity at a discount to the generally available pipeline tariff provide a new option for connecting to upstream and downstream markets. The value of such options has been limited to date because, in a fully contracted market[9], niche supply opportunities are difficult to exploit. However, as market participants become accustomed to more flexible trading conditions, it can be expected that such opportunities will be keenly sought.

As the Commission correctly notes in its Issues Paper, over-contracting of capacity can be misused by upstream and downstream market participants to restrict competition. Such over-contracting is difficult to eliminate because there are valid reasons for pre-committing to purchase pipeline capacity, for example, for planning purposes. It can be difficult to distinguish between legitimate pre-commitments of pipeline capacity and those which are used to restrict the availability of capacity to potential users. The means available to minimise the impact of over-contracting include:

[9] This is a function of the long term, take or pay contracts which have historically characterised the market.

(a) maximising competition and the ease of entry in all markets along the gas supply chain to minimise opportunities for marking up prices to fund market manipulation by over-contracting;

(b) requiring Service Providers to trade contracted capacity which is unutilised or under utilised;

(c) making it illegal to hinder access to pipeline capacity; and

(d) requiring those entities that over-contract for pipeline capacity (those with unutilised contracted capacity) to put in place an Access Arrangement for this capacity.

Of these measures, (a) and (b) would be considered to be part of the current competition reform model, (d) has been considered in the past and not pursued and the prohibition on hindering access (c), is part of the National Access Regime and the Gas Access Regime.

Whilst over-contracting for pipeline capacity might be used to withdraw capacity from the market, and damage competition, the Gas Access Code appears to have the capacity to address such abuse.

5. Pricing Mechanisms

5.1 The pricing objective

Recommendation Eight: The efficient costs used in setting the Reference Tariff should be determined having regard to the over riding objective to promote the efficient use of, and investment in, gas pipelines.

In its terms, the Code provides a broad range of matters which inform the Regulator's decisions regarding a Reference Tariff. These are dealt with in s8 of the Code and are not repeated here. It is, however, interesting to note the ways in which the various issues are addressed:

(a) Clause 8.1 sets out objectives which a Reference Tariff and a tariff reference policy should seek to achieve.

(b) Clause 8.2 sets out factors about which the relevant Regulator must be satisfied in determining to approve a Reference Tariff and Reference Tariff policy.

(c) Clause 8.4 stipulates methodologies for calculating total revenue.

(d) Clause 8.11 provides that the initial capital base should normally fall between the Depreciated Actual Cost ("**DAC**") and Depreciated Optimised Replacement Cost ("**DORC**").

The Full Court of the Supreme Court of Western Australia has recently considered the approach to tariff setting under these provisions and, in so doing, has given consideration to the interpretation of the factors set out in clause 8.1. These are usefully summarised in an article by Henry Ergas entitled, "Epic in Retrospect and Prospect"[10]. As Mr Ergas notes in that article, a principal issue which arises from the decision is that, rather than providing clarity as to the way in which the various factors should be approached, the Supreme Court decision has in fact vested greater discretion in the Regulator than may otherwise have been thought to be the case. For example, the approach which it has taken to the notion of "legitimate business interests and investment" is broader than may have been thought to be the case. In part, this difficulty arises from the nature of the language of clause 8 of the Code itself.

In WMC's submission, the position which has been reached in light of the Epic decision is that there is such a high level of uncertainty that the clarification of the approach to tariff setting is required. For example, the implication of 8.1(b), when applied to the specific question of tariff structure, could be usefully clarified. Similarly, whilst the initiated may focus on marginal cost, poll type charges and like issues when considering 8.1(e), clarification of the purpose of this objective would be helpful. In particular, is 8.1(b) focussed on tariff levels and 8.1(e) focussed more on tariff structure?

The current arrangements for determining Reference Tariffs provide a very high level of discretion to the Regulator with little guidance as to priority setting within the context of the matters which must be taken into account. Recent judicial decisions have enhanced rather than reduced this uncertainty.

In WMC's submission, the current situation does not assist either users or Service Providers and the approach to determining tariffs both in the arbitration processes, the Reference Tariff mechanisms and the revenue cap mechanisms. WMC believes that this uncertainty will continue unless there is clarification of the overall objective of the Gas Code and clearer specification of the key objective to be achieved in setting the Reference Tariff.

5.2 The role of Reference Tariffs

Recommendation Nine: The Reference Tariff should be set as a third party access tariff with clearly defined parameters and should be consistent with the overriding objective of achieving efficient investment in, and utilisation of, the relevant pipeline.

Section 8 of the Code contains a wide range of options both in regard to the form of proposed Access Arrangements and the approach to tariff making and in so doing grants to the Regulator

[10] National Economics Consulting Group (NECG) note, unpublished

wide ranging discretions. However, proposed Access Arrangements and regulatory decisions have rapidly moved to a single format and focussed on the minutiae of the regulatory calculation.

This appears to have arisen from the tendency of the regulatory decisions to ascribe foundation shipper status to third parties with the result that the Gas Access Regime has become a de facto price fixing regime. In WMC's submission, this is not a necessary consequence of the Code provisions but rather seems to reflect a narrow and inappropriate interpretation/application of the Gas Access Regime.

Whilst it may have been the intention of the Gas Access Regime that Reference Tariffs set an upper bound on prices for access seekers in negotiations with a pipeline owner/operator, the reality is that it has only done so by setting price for all users equivalent to that of foundation shipper contracts.

In WMC's submission, the Reference Tariff should be the tariff applicable to a set of third party reference terms. Neither these terms nor the Reference Tariff should be equivalent to foundation terms and tariffs.

6. Benefits of the Regime to Competition in Dependent Markets

6.1 Overall impact of the regime

The Gas Access Regime is important in facilitating the integration of gas (and energy) markets and arbitrage between those markets. The Gas Access Regime ensures that arbitrage between markets occurs by providing interconnections. It is this facilitation of competition between markets which is the precursor to the development of a national market. This arbitrage will ensure that market price signals will generate extension and interconnection of the transmission pipeline network as and when the market demands.

WMC would be concerned if it could be shown that the Gas Access Regime, or the administration of the Gas Access Regime, acted to discourage or distort investment in pipeline capacity.

There may be a proposition that a regulatory regime which constrains the size of the downstream market for gas may promote upstream gas-on-gas competition by forcing producers to contest a smaller market. But, in the medium to long term, such a situation is likely to also constrain upstream investment and erode competition in both the upstream and downstream markets.

There seems little to argue with in the proposition that markets located upstream to and downstream from a gas pipeline will benefit most from competition if access to the capacity of that pipeline is unconstrained and if there is freedom of entry to new investment in pipeline

capacity. WMC would be concerned with any regulatory regime which distorted or constrained investment in pipeline capacity.

6.2 Enhanced upstream competition

Recommendation Ten: Open access to transmission pipelines is a fundamental condition to secure competitive upstream gas markets. Any changes proposed to the Gas Access Regime should be tested to ensure that they will not result in limiting the scope for upstream competition.

WMC submits that there is evidence that the Gas Access Regime has had major beneficial ramifications for both investment and competition in upstream (gas supply) markets. However, access to gas transportation infrastructure is a necessary, but not a sufficient, condition for promoting investment and competition in upstream markets.

The impact of the Gas Access Regime appears to have been different in different locations, which is likely to be a function of the differing characteristics of the relevant upstream and downstream markets.

To further develop competitive conditions, it is not only the introduction of new Service Providers but also maturer competitive markets which are reflected in:

(a) gas users contracting with multiple suppliers to build gas supply portfolios;

(b) shorter contract duration;

(c) greater flexibility in contract offtake; and

(d) the shifting (physical and contractual) of gas between markets.

Each of these demands assumes access to gas transportation facilities to manage and exploit risk.

WMC sees that, particularly in Western Australia, upstream competition is developing. Overall, WMC would not, however, regard gas markets as effectively competitive nor does it believe that such competition will continue if open access to transmission pipelines is removed. The description, in the Parer report[12] of eastern gas markets as "emerging" is an accurate assessment. As the Parer Committee noted, there are currently "*limited secondary markets associated with natural gas in Australia and at the same time, a strong dependence on very long term (by international standards) take or pay contracts within the gas sector*"[13]

[12] Council of Australian Governments Energy Market Review December 2002.

[13] Ibid at 190.

The more competitive upstream conditions in Western Australia appear to have arisen out of the restructuring of the long term gas supply contracts which were in place between the State Energy Commission of Western Australia (**"SECWA"**) and the North West Shelf Gas Joint Venture (**"NWSGJV"**) and the development of open access (albeit sometimes limited) on the DBNGP and the Goldfields Gas Pipeline. This restructuring resulted (as far as can be ascertained from publicly available commentary[14]), in changes including:

(a) the break up of the purchase of gas by SECWA between five major gas consumers; and

(b) the revision of the Pilbara Gas Price formula.

This major contract and market restructuring, was complemented and consolidated by the development of the GGP. This, in turn, led to an increase in the supply of gas from smaller gas developments such as East Spar, Harriet and Tubridgi[15]. For example, the East Spar gas field was originally developed as part of the GGP project to supply WMC's requirements and subsequently has secured gas supply contracts with Wiluna, Jundee, Cawse and other gas users along the GGP and the DBNGP[16].

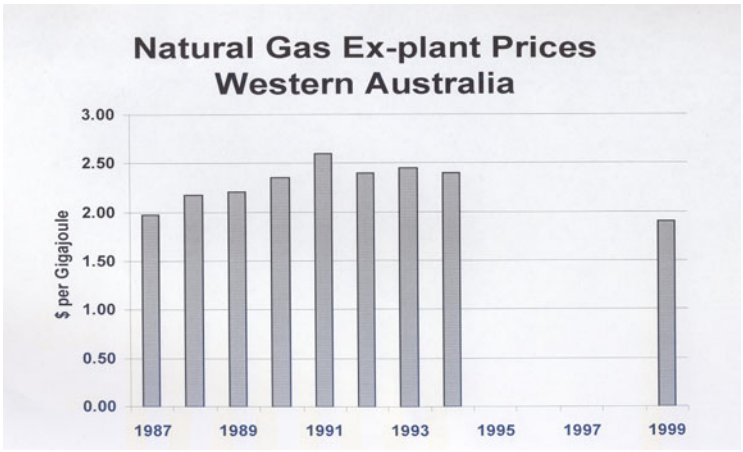
These developments, the Western Australian ex-field gas price significantly decreasing in 1999. The graph below provides a brief history of ex-field gas prices in Western Australia as summarised by the Australian Gas Association and emphasises the competitive significance of the smaller gas fields.

[14] "Disaggregation of the North West Shelf Domgas Contract" at http:\\www.energy.wa.gov.au\html\body_l_t_7.html.

[15] AlintaGas (formerly SECWA) entered into a 10 year gas supply contract with the owners of the Tubridgi field which expired in 2001. Pursuant to this contract, AlintaGas was supplied with 56PJ of gas at a rate of up to 23 TJ/d: WA Oil & Gas Industry 2002 page 52

[16] WA Oil & Gas Industry 2002 page 52

Western Australian Ex-field Gas Prices 1987-1999



Source: AGA 1999 Resource for Members and Gas Statistics, Australia 2001, Table 4.3

In Queensland, delays in implementing the Gas Access Regime and the absence of uncontracted gas demand has delayed the emergence of investment and increased competition in upstream markets. However, the increased credibility of coal seam methane ("**CSM**"), government support for a gas (CSM) fired Townsville Power Station and the expiry of major existing gas contracts in the period 2005-2008 are fostering major changes to the Queensland gas market. If these changes are to have a significant impact beyond Townsville and Gladstone, the successful implementation of the Gas Access Regime will be indispensable.

WMC has no doubt that the Gas Access Regime is at least partially responsible for major gas production and storage investment and for substantially increased gas on gas competition in major Australian gas markets. This investment and enhanced competition could not have arisen if other market conditions, including the tightening of gas supplies and the emergence of uncontracted demand, were not present, but the importance of access to gas delivery infrastructure cannot be underestimated. WMC's experience is consistent with that of the Parer review in that WMC is not aware of any specific instances where the Code has adversely affected the development of upstream competition. Rather, to the contrary, WMC agrees with the conclusion of the Parer Committee that, "*Economic regulation will continue to be required for some key infrastructure in the Australian Gas Market. However, the form of that regulation should remain consistent with the needs of the market as it develops*".[17]

It would be an error to surmise that competition, once established, will endure if the ingredients that gave rise to that competition are removed. It is not historical open access to pipeline capacity which produces competitive changes in the market but the assurance of continuing access on predictable terms. Without such assurance gas users will be forced to

[17] Ibid at 192.

protect their long terms energy supplies and reverse the trends to multiple gas sourcing, reduced contract durations, etc.

A particular example of the competition benefits of the Gas Access Regime is WMC's decision to have gas (which is purchased on the North West Shelf and transported to Dongara in the DBNGP) delivered into the Parmelia Pipeline at Dongara for delivery to Kwinana. Previously WMC used the DBNGP to transport this same gas all the way to Kwinana.

6.3 Downstream Competition

The impact of access to transmission pipelines on investment and competition in downstream markets is more complex. Indeed, there are at least four generic downstream industries which need to be considered in this context, namely:

(a) footloose petrochemical processing industries;

(b) petrochemical processing industries drawn to a particular market, resource or location;

(c) industries which use an intermediate product produced using gas (electricity, steam, etc); and

(d) the market for inputs to intermediate products in downstream markets.

The principal difference between petrochemical industries and other industries relates to the significance of feedstock gas in the petrochemical plant's cost structure and, thus, the petrochemical sector's heightened price elasticity of demand for gas.

Major footloose petrochemical investment is inevitably drawn to locations where the social and economic infrastructure necessary to support the investment exist and, otherwise, where gas prices are at their lowest. By definition, these locations tend to be at the sources of gas production (or, in the case of gas produced off shore, near the point of landfall). As a rule, investors do not entertain adding to the cost of gas by transporting feedstock gas from locations where it is produced or, in the case of off-shore gas production, makes its first landfall. Such industries are typified by those recently cited as considering Darwin and Burrup Peninsula locations for major new investment. Such industries are internationally footloose and their investment decisions are not normally affected by consideration of access to gas transmission infrastructure.

Investment in petrochemical plants which are drawn to locations in proximity to a market or raw material (eg, WMC's Duchess phosphate operation) is potentially affected by the terms of access to gas transmission infrastructure. However, consideration of gas transmission costs form part of a revenue and cost matrix which must, in aggregate, be used to justify the

investment. Access to gas transmission infrastructure will influence investments and competition in these downstream markets.

In those industries which use gas to produce an intermediate product for use in further production, the role of open access in promoting competition is clear. In particular, there are examples in Western Australia of mining companies which are able to, at least partially, defray the cost of their electricity supplies by actively competing to sell electricity in the open market in Kalgoorlie and Perth. Further entry of mining companies into this market, and the capacity of those companies to provide terms of supply required by the market, is dependent upon continuing and open access to gas transmission infrastructure.

In addition to the competitive impact of producers of intermediate products in non-core markets, access to gas transmission infrastructure has facilitated the substitution of natural gas for other inputs to produce both intermediate and final products. Natural gas is now an input to production and an alternative primary energy source in the Northern and Eastern Goldfields of Western Australia, the East Pilbara and North East Queensland. In these markets the arrival of gas has fundamentally changed the competitive environment in the primary energy market by promoting competition in fuel and in related technology markets.

It is true that much of the competitive activity in downstream markets which is referred to above is currently undertaken by foundation shippers on transmission pipelines (that is to say, shippers with contracts which are not the product of open access legislation) but this is a transitional phenomenon. Although WMC is a user of open access transmission pipelines in Western Australia and Queensland, none of these pipelines is properly governed by open access legislation to date and none was regulated when WMC needed to contract for the relevant services. WMC is confident that the current dominance of foundation shippers will diminish over time if, and when, open access is properly given effect. Current trends, however, demonstrate that open access will have a significant impact on competition.

In addition, there are significant allocative efficiency gains which arise from the Gas Access Regime. One of the traditional problems faced when negotiating foundation shipper contracts for access to gas transmission pipelines has been to limit the monopoly power of the pipeline owner insofar as access to future incremental gas transmission capacity is concerned. That is to say, the terms on which access to pipeline capacity, which is over and above the foundation contract quantities, is offered to existing and prospective shippers. At the margin, this capacity could be provided at a low marginal cost, whereas pipeline companies have sought to provide the service at a price equal to the sum of the sunk historic cost of the pipeline (averaged over historic sales) plus the incremental cost of pipeline capacity enhancements (averaged over incremental sales). That is to say, the capacity is often offered to the market at the prevailing tariff plus incremental costs.

This pricing methodology represents a "double dip" on sunk cost, resulting in overpricing of the service and allocative inefficiency and under supply/consumption. Foundation contracts have typically sought to:

(a) avoid this double dip, by various means, insofar as the foundation shipper is concerned; and

(b) share the benefits of new and low cost incremental pipeline use with foundation shippers who have underwritten historic costs.

The pricing and other provisions of the Gas Access Regime are designed to share the costs of pipeline capacity fairly and to preclude pipeline owners from double dipping on the recovery of sunk cost. (In some incentive based arrangements the Gas Access Regime may limit, rather than circumvent, this double dip by imposing a sunset to pricing practices).

The pricing and other provisions of the Gas Access Regime should deliver lower, cost-based access to incremental pipeline capacity to both foundation shippers and third parties. Whilst foundation shippers have typically striven to deliver this outcome for themselves in foundation contracts, these attempts have been imperfect. Prior to the introduction of the Gas Access Regime, the only protection afforded to third parties from the abuse of monopoly power by pipeline owners was ad hoc intervention by the relevant Ministers. As such, where the Gas Access Regime is properly implemented, it should deliver allocative efficiencies. The extent of these gains are limited by the practical limits on designing efficient pricing structures for pipeline services, but there is little doubt that the results of the Gas Access Regime are more efficient than the outcomes of imperfect markets.

As it has been applied, the Gas Access Regime does not appear to have provided or increased certainty for Service Providers. Indeed, by replicating the foundation shipper's terms of access and applying those terms to third parties, the Gas Access Regime may have undermined the certainty of pipeline Service Providers by undermining:

(a) the propensity of potential shippers to become foundation shippers; and

(b) the protection sought by foundation shippers against cross subsidising third party access to pipeline services.

If the terms of third party access were defined to include terms, conditions and prices consistent with short term, convenient use of the pipeline, the pipeline Service Provider would be able to develop incremental capacity as a market based provider or to negotiate foundation shipper support for the investment. This negotiated support for investment would involve the shipper accepting reduced contract flexibility in return for prices below the regulated tariff. Since the Gas Access Regime is capable of being administered using this alternative approach, the creation of unmet demand does not appear to be an inherent feature of the regime.

Whilst it is often argued that the undersizing of pipeline capacity is the result of the Gas Access Regime, experience with Australia's oldest open access pipeline (the Wallumbilla to Brisbane Gas Pipeline) suggests that Australian pipeline companies have not invested in pipeline capacity ahead of foundation contract commitments.

7. Incentives for Investment

7.1 Certainty as to coverage

Recommendation Eleven: WMC supports the introduction of binding coverage rulings as proposed by the Council of Australian Governments Energy Market Review.

Every investment decision involves risk assessment and decisions to invest in pipelines are no different. To maintain an acceptable balancing of interests, the regulatory environment must provide a mechanism for delivering sufficient certainty about the likelihood of regulation and the framework within which decisions as to regulated terms and conditions of access will be made. No regulatory regime is going to, in effect, provide a guarantee to an investor that no matter what changes occur in technology, market demand or other factors, a particular piece of infrastructure is immune from regulation. What a regulatory regime can do, however, is to provide a credible and reliable mechanism for assessing the risks of regulation *ex ante*, and provide a mechanism for limiting the boundaries for regulation if regulation is to occur. The advantages of this type of structure are that:

(a) it disciplines the coverage body and the Regulator to consider issues at the time the firm is facing the investment risk;

(b) it obliges the coverage body and the Regulator to support their opinions with explicit findings on issues of fact which cannot be changed in any arbitrary way; and

(c) *ex ante* risk assessment is less costly.

Therefore, the key attributes of a regulatory regime for investors considering new investment (whether greenfields or upgrades of existing infrastructure) are:

(d) certainty and consistency in the regulatory environment;

(e) the provision of an appropriate level of return so that an environment is created which creates appropriate incentives for investment; and

(f) sufficient transparency and review mechanisms available to it to ensure that there is a broad level of confidence in the system across all stakeholders.

In WMC's submission, there is no evidence to suggest that the Gas Access Regime has adversely affected incentives for investment. However, WMC would not be adverse to further developing the Gas Access Regime mechanisms to provide greater certainty.

WMC believes that there is merit in adopting the recommendation of the Commission in the Part IIIA recommendation for binding rulings as to coverage. Whilst this was not adopted by the Government in the context of Part IIIA, the Government did foreshadow that it would be considered in the context of industry specific regimes.

The introduction of binding upfront rulings was endorsed by the Parer Committee. Under the current provisions in the Gas Code a party can seek an advance "opinion" from the NCC as to whether a proposed pipeline would meeting the criteria for coverage. However, any such opinion is not binding on the NCC.

WMC supports the recommendation of the Parer Committee that the "*Gas Code be amended to enable the granting of binding coverage rulings for fixed periods of time, but with no ability to revoke that ruling within the periodunless information relied upon proves to be false or intentionally misleading."* [18]

7.2 Upfront regulatory arrangements

Another issue which the Commission has previously examined in the context of providing certainty for investment in infrastructure is upfront regulatory arrangements. The Code currently provides for upfront regulatory arrangements. However, whilst the length of those arrangements can be any period, if the Access Arrangement is proposed for a period of more than five years, the Regulator is required to consider whether mechanisms should be included to address the risk of forecasts on which the terms of the Access Arrangement were based proving incorrect. Examples of potential mechanisms include benefit sharing of revenues beyond a pre-agreed amount or a trigger for review of the Access Arrangement if certain events occur.

The practical problem which therefore arises is whether these arrangements are such as to, in substance, provide no more than a 5 year regulatory arrangement. If that is the effect of the arrangement then, given the long term nature of the investment, it provides little real comfort to the pipeline investors. From WMC's perspective, it is not clear whether pipeline investors have simply not chosen to avail themselves of the mechanisms which are available or whether there is such uncertainty in the structure of the arrangements contemplated by the Code that the arrangements are not commercially useful. WMC notes that the ACCC has issued a Greenfields Guideline paper and that the Central West pipeline has an Access Arrangement

[18] Parer Committee Report at 211

which is to be in place for a period of ten years in recognition of the time necessary to develop a market for natural gas in the central west of New South Wales.

WMC considers that such upfront regulatory arrangements have the capacity to provide significant certainty and are consistent with the issues identified by the Commission in its review of Part IIIA. If the other recommendations suggested by WMC in relation to the primary objective of the Code and the assessment of Access Arrangements are implemented, then it is likely that advance regulatory arrangements are likely to be more attractive to pipeline investors.

7.3 Access Holidays

One suggestion which has been raised is to establish regulation free periods for new transmission pipelines. This has some attraction when pipeline construction is being contemplated because one would generally expect that investors in new pipeline infrastructure have an incentive to maximise throughput and, at that point, the countervailing power of users is at its greatest. There are, however, significant risks with such a proposal particularly if there are vertical linkages between the pipeline owner/operator and participants in downstream markets. Generally, WMC prefers the use of advance regulatory arrangements to manage the investment risk associated with the construction of new pipelines as those arrangements are likely to have a greater prospect of promoting competitive dependent markets than fixed regulatory free periods.

If, however, the Commission were minded to adopt an access holiday type proposal, in WMC's submission, it would need to, at a minimum, meet the conditions proposed in the Parer Report, namely that:

(g) it be a new transmission pipeline;

(h) it be structurally separate from participants in dependent markets;

(i) there be published tariffs for access to the pipeline; and

(j) all capacity must be fully tradeable.

7.4 Funding Capacity Expansions

One issue raised by the Commission is whether the Gas Access Regime has led to unmet demand where consumers would be willing to pay more to increase supply but Service Providers are unwilling to make the necessary investment. It is difficult, again, to separate the provisions of the Code, the effects of the current approach to administration of the Gas Access Regime and industry rhetoric. There are cases reported where pipeline Service Providers have purportedly declined to install incremental pipeline capacity to meet users' needs on the basis that the returns from such investment are inadequate. It is not clear, however, whether this

behaviour flows inevitably from the regime or whether it flows from the administration of the regime.

If the terms of third party access were defined to include terms, conditions and prices consistent with short term, convenient use of the pipeline, the pipeline Service Provider would be able to develop incremental capacity as a market based provider or to negotiate foundation shipper support for the investment. This negotiated support for investment would involve the shipper accepting reduced contract flexibility in return for prices below the regulated tariff. Since the Gas Access Regime is capable of being administered using this alternative approach, the creation of unmet demand does not appear to be an inherent feature of the regime.

7.5 Investment in downstream markets

Because of delays in implementing the Gas Access Regime, WMC has not, to date, experienced the benefits of the Gas Access Regime in any of the jurisdictions in which it purchases gas transmission services. WMC is, however, considering expansion plans at various of its operations which will lift its gas consumption needs above the levels covered by its foundation contracts. WMC is confident that the terms on which it can negotiate access to these incremental services will be more reasonable if the relevant pipelines are subject to a properly administered Gas Access Regime.

8. Coverage

8.1 The Coverage Criteria

Recommendation Twelve: No change be made to the coverage criteria in the Gas Access Regime.

WMC considers that the approach to be taken to interpreting the coverage criteria is now reasonably well settled. WMC would describe the analytical approach to be undertaken as follows:

(a) Identify the services provided by means of the pipeline. In doing so, the services are services for delivery of gas from one point to another and points along the route. The services are not defined by reference to the opportunities at the origin and/or the destination of the relevant pipeline and no analysis of markets at the point of origin or the final destination is necessary or appropriate[19].

(b) Having determined the services provided by means of the pipeline, examine whether a single pipeline is able to meet the relevant demand at less cost than two or more pipelines. If so, it would be "uneconomic" for the purposes of criterion (b)

[19] Re Duke Eastern Gas Pipeline Pty Limited (2001) ATPR 41-821 at 43,060

to develop another pipeline to provide the same services because those services are most efficiently provided by the existing pipeline. In considering the question of "cost", it is not simply a question of financial cost but the cost to society[20] and in that regard, account must be taken of productive efficiency (i.e. production at least cost), allocative efficiency (i.e. the provision of services to those that value them most highly) and dynamic efficiency (i.e. the preservation of incentives for innovation and investment).

Criterion (b) requires existing pipelines to be considered when determining whether or not criterion (b) is satisfied. That will involve an examination of the capacities and expansion costs of existing pipelines. On that basis, in the Eastern Gas Pipeline case, the Tribunal examined whether the Interconnect could have been developed to provide the services provided by means of the Eastern Gas Pipeline.

(c) Criterion (a) requires an assessment of whether the creation of the right of access for which the Code provided would promote competition in an upstream or downstream market. For the purposes of this enquiry one must consider the future with and without coverage of the pipeline. The notion of the promotion of competition in criterion (a) is principally concerned with the removal of barriers to entry which inhibited the opportunity for competition in the relevant market.

(d) Criterion (c) asks whether there are any reasons why access, as provided for under the Code, would cause any undue risk to health or safety.

(e) Criterion (d) does not constitute an additional positive requirement which could have been used to call into question the result obtained by application of the other three criteria. Rather, criterion (d) accepts the results derived from the application of the other three criteria but enquires whether there were any other matters which led to the conclusion that coverage would have been contrary to the public interest.

This approach is consistent with the objectives of the Gas Access Regime in identifying substantial market power in the provision of transmission services which can be used to distort competition in related markets. In WMC's submission, the application of criterion (a) is of importance particularly given the application for revocation of coverage of the Moomba to Sydney pipeline. The approach adopted by the Australian Competition Tribunal in the Eastern Gas Pipeline case cannot be used to suggest that in all cases where there is more than one pipeline serving market demand it will be appropriate for none or only one of those pipelines to be regulated. Whether or not coverage will promote competition must be assessed by reference to detailed market conditions operating at the relevant time. It seems to WMC that

[20] Re Sydney International Airport (2000) ATPR 41-754

underlying much of the Tribunal's assessment of Duke's market power in the Eastern Gas Pipeline case was the fact that the Moomba to Sydney pipeline was regulated under the Code.

8.2 Effectiveness of the revocation process

The relatively high incidence of revocation applications under the Gas Access Regime are a legacy of the coverage model included in the Code. That model provided that all pipelines identified in Schedule A in 1997 were automatically covered. Thus, the revocation applications lodged under the Gas Access Regime fall into two categories:

(a) those relating to pipelines which are unlikely to have ever satisfied the coverage criteria and were included in a broad policy approach; and

(b) those designed to test the application and interpretation of the Gas Access Regime.

The pipelines falling into the first category are generally single user lateral pipelines from a major transmission pipeline to an end user's consumption site. The process of securing revocation for these pipelines has proved relatively expedient and effective.

In regard to applications for revocation designed to test the application and interpretation of the Gas Access Regime (Eastern Gas Pipeline, Moomba to Sydney Pipeline and GGP, it is appropriate that these applications be assessed against a mirror image test to the coverage test. That is to say, revocation should not be granted where the pipeline would be covered if it were subject to the coverage test.

Thus, if contrary to WMC's submission, the Commission considered it appropriate to make changes to the coverage test, those changes should be mirrored in the revocation test. Otherwise, the revocation provisions of the Gas Access regime do not require further improvements.

It is important to acknowledge the importance of "sunset provisions" in the recommendations of the Hilmer Report. A key tenet of the recommendations of that report was that, once introduced, regulation should not apply indefinitely without reconsideration of its relevance. The role of revocation applications in the Gas Access Regime is as a proxy for a sunset clause on coverage decisions. It is, therefore, important that revocation be retained as part of the Gas Access Regime.

9. Regulatory Arrangements

9.1 Regulators Applying for Coverage

The Commission has asked what are the advantages and disadvantages of allowing Regulators to apply for coverage of pipelines which they will regulate?

Before responding in regard to this issue it is first necessary to comment on Figure 1 of the Commission's issues paper. Specifically, Figure 1 appears to imply that an application to cover a pipeline must be preceded by a failed access negotiation.

This is not WMC's understanding of the arrangements for coverage set out in the Gas Access Regime. It is WMC's understanding that "any person" can, at any time, seek coverage of a pipeline. There is no qualification which the "person" need possess and there is no requirement for any specific activity to precede a request for coverage.

In this light, there does not seem to be a strong argument that it is inappropriate for the Regulator to seek coverage of a pipeline. Providing the Regulator is not a party to the coverage decision, there would not appear to be any basis for suggesting that Regulators should be conflicted from requesting coverage of a pipeline. There is a substantial difference between the role of Regulators in the coverage process and the role of Regulators after a pipeline has been covered.

There is a more fundamental question as to whether a Regulator should participate in the coverage process as an advocate for or against coverage. There is no doubt that a Regulator, having taken a position on whether or not a pipeline should be covered, should not then be involved in regulation of that pipeline.

WMC submits that there is no basis for precluding a Regulator seeking coverage of a pipeline. Indeed, if the Regulator is actively involved in gas pipeline issues, there may be significant benefit to be gained from empowering an informed market participant to request coverage. However, there is equally no doubt that Regulators should not be involved in deliberations regarding coverage, nor should they take an active role in the coverage process. Regulators, having raised the question of coverage, should be prepared to allow the decision on coverage to be made by the relevant parties and should not compromise their future capacity to regulate those assets/services.

Whilst the above comments on the role of the Regulator are directed specifically at the question of coverage, they apply equally to the question of whether Regulators should engage in applications for revocation.

9.2 Regulators determining the level of regulation

Recommendation Thirteen: There should be separation between the persons making the decision about whether or not a pipeline should be subject to the Gas Access Regime and the persons who make the decisions about the regulatory arrangements once a pipeline is subject to coverage. WMC would not support the two decisions being made by the same body.

The suggestion that the regulator should determine the level of regulation is entirely inappropriate. There should be a marked separation between the regulator and the determination of whether regulation should apply, and the extent or nature of that regulation.

The idea of providing the regulator with incentives to make decisions is an anathema to good policy.

Appendix A

Table 1 - Goldfields Gas Pipeline - Access Issues Chronology

Date	Event
15 December 1999	GGT, on behalf of the Pipeline Owners, submitted to the Regulator: • the proposed Access Arrangement; • Access Arrangement Information; and • maps in relation to the Pipeline ("Proposed Access Arrangement").
17 December 1999	The Regulator published an Invitation for Public Submissions on the Proposed Access Arrangement.
11 January 2000	The Regulator published an Issues Paper on the Proposed Access Arrangement.
February - March 2000	Public Submissions - 1st Round on Proposed Access Arrangement.
10 April 2001	The Regulator handed down a draft decision on the Proposed Access Arrangement (after consulting with the public) ("Draft Decision").
July 2001	Public Submissions in response to Regulator's Draft Decision.
1 August 2001	Epic Energy announced that it would commence legal action against the Regulator in relation to his draft decision on the proposed Access Arrangement for the DBNGP.
28 August 2001	Order *nisi* granted by Templeman J in relation to Epic Energy challenge of Regulator's Draft Decision for the DBNGP ordering writs of *certiorari*, prohibition and *mandamus* be determined by Full Federal Court.
13 December 2001	The Pipeline Owners commenced proceedings in the Supreme Court of Western Australia against the State and the Regulator in relation to the Draft Decision and alleged inconsistencies with the provisions of the State Agreement.
23 August 2002	The Full Court of the Supreme Court of Western Australia delivered its decision in *Re Dr Ken Michael AM; Ex Parte Epic Energy (WA) Nominees Pty Ltd & Anor* [2002] WASCA 231 ("Epic Energy case").
6 November 2002	In response to the Epic Decision, the Regulator issued a notice inviting further submissions in relation to his Draft Decision concerning the Pipeline, particularly having regard to the

Date	Event
	reasons in the Epic decision and the effect of that decision on matters identified in the Draft Decision ("Notice").
December 2002	The Pipeline Owners discontinued their Supreme Court proceedings, supposedly on the basis that since the Regulator intended to review his decision in light of the Epic Decision a number of the issues pleaded had been resolved.
17 December 2002	Submission by GGT, WMC and Newmont to the Regulator in response to the Notice.
27 March 2003	GGT submits application for revocation of coverage of the GGP to the NCC
April 2003	NCC published Issues Paper on application for revocation of coverage of the GGP
May 2003	Public submissions on application for revocation of coverage of the GGP
June - August 2003	NCC extends time for publication of draft decision on application for revocation of coverage of the GGP to 4 September 2003
December 2002 - June 2003	The Regulator issues Notice of extension of time to assess the Proposed Access Arrangement. The most recent extension of time was issued by the Regulator on 15 August 2003 extending the release of an Amended Draft Decision until 15 October 2003.

Table 2 - Dampier to Bunbury Natural Gas Pipeline - Access Issues Chronology

Date	Event
15 December 1999	Epic Energy submit to the Regulator: • the proposed Access Arrangement; • Access Arrangement Information; • maps • other miscellaneous documents in relation to the pipeline ("Proposed Access Arrangement").
17 December 1999	The Regulator published an Invitation for Public Submissions on the Proposed Access Arrangement.
11 January 2000	The Regulator published an Issues Paper on the Proposed Access Arrangement.
January to March 2000	Public Submissions - 1st Round on Proposed Access Arrangement.
17 March 2000	The Regulator published a Notice closing the Public Submissions on the Proposed Access Arrangement.
April - May 2000	Public Submission - 2nd Round on Proposed Access Arrangement.
17 August 2000	Epic Energy submit revised Access Arrangement Information to the Regulator.
21 June 2001	The Regulator handed down a draft decision on the Proposed Access Arrangement ("Draft Decision").
June 2001 - February 2002	Public Submissions in response to Regulator's Draft Decision.
1 August 2001	Epic Energy announced that it will commence legal action against the Regulator in relation to his draft decision on the proposed Access Arrangement.
28 August 2001	Order nisi granted by Templeman J in relation to Epic Energy challenge of Regulator's Draft Decision ordering writs of certiorari, prohibition and mandamus be determined by Full Federal Court.
23 August 2002	The Full Court of the Supreme Court of Western Australia delivered its decision in *Re Dr Ken Michael AM; Ex Parte Epic Energy (WA) Nominees Pty Ltd & Anor* [2002] WASCA 231 ("Epic Energy case").

2 September 2002	The Regulator issued an Information Paper on the process of the Regulator following the Supreme Court decision in the Epic Energy case.
October 2002 - May 2003	Public Submissions in response to Epic Energy case, the Regulator's Draft Decision and the Information Paper.
23 May 2003	The Regulator released its Final Decision on Proposed Access Arrangement.
June - August 2003	The Regulator has issued two Notices extending the time for Epic Energy to submit a revised Access Arrangement for the pipeline. The most recent extension of time was granted on 15 August 2003 granting an extension until 15 October 2003.

Table 3 - Moomba to Sydney Pipeline System - Access Issues Chronology

Date	**Event**
5 May 1999	East Australian Pipelines Limited (**"EAPL"**) submit proposed Access Arrangement to the ACCC
4 June 1999	ACCC publishes an Issues Paper on the proposed Access Arrangement
20 December 2000	ACCC publishes Draft Decision on Proposed Access Arrangement
February to May 2001	Public Submissions on ACCC Draft Decision on Proposed Access Arrangement
4 May 2001	Australian Competition Tribunal delivers its decision in Duke Eastern Gas Pipeline Pty Ltd [2001] ACompT 2 ordering that the decision of the Minister made on 16 October 2000 that the Eastern Gas Pipeline should be a Covered Pipeline be set aside and in lieu of that decision deciding that the pipeline should not be covered.
18 June 2001	EAPL submit application for revocation of two pipelines in the MSP system to the NCC
3 July 2001	Letter from ACCC to EAPL advising of postponement of Final Decision until NCC publishes its decision in relation to application for revocation of coverage
11 January 2002	Letter from ACCC to EAPL advising that Final Decision will not be postponed and requests submission of revised Access Arrangement
5 February 2002	Consultant report - Depreciation within ODRC valuations (Sinclair Knight Merz)
30 April 2002	EAPL submit revised Access Arrangement to the ACCC
27 May 2002	EAPL submit additional information to revised Access Arrangement to the ACCC
20 June 2002	ACCC publishes an Issues Paper on the revised Access Arrangement

July 2002	Consultant report - Empirical evidence on proxy beta values for regulated gas transmission pipelines (The Allen Consulting Group)
July to August 2002	Public Submission on revised Access Arrangement
September 2002	Consultant report - Depreciation within ODRC valuations (National Economic Research Associates)
September 2002	Consultant report - Hypothetical new entrant test (National Economic Research Associates)
25 September 2002	EAPL's response to submissions on revised Access Arrangements
5 November 2002	EAPL's responses to Consultant reports - • Network Economics Consulting Group response to Allen Consulting Group report on proxy beta values for regulated gas transmission pipelines. • Agility response to National Economic Research Associates report on ODRC • Agility response to Sinclair Knight Merz report on ODRC
5 November 2002	Australian Pipeline Trust (**"APT"**) submission on the impact of the Epic Decision on the Draft Decision by the ACCC
11 November 2002	ACCC publishes Issues Paper on the impact of the Epic Decision
14 November 2002	Legal advice from KPMG on the impact of the Epic Decision on the Draft Decision by the ACCC
14 November 2002	NCC issues its final recommendation to the Hon. Ian Macfarlane MP, Minister for Industry, Tourism and Resources, that coverage of the pipelines not be revoked.
December 2002	Duke Energy response to ACCC Issues Paper on the impact of the Epic Decision
28 January 2003	Energy Market Reform Forum response to Issues Paper on the impact of the Epic Decision
14 February 2003	APT response to submission by Duke and EMRF on impact of the Epic Decision
17 February 2003	APT submission concerning ABDP Final Decision
20 May 2003	Venton and Associates (on behalf of APT) submit MSP Review of Optimised Design for 2003 load reforecast
23 May 2003	APT submission to ACCC on impact of revised forecasts on the Optimised Replacement Cost of the MSP attaching Venton and Associate's Optimised Replacement Cost - Estimate Contingency.
May 2003	ACIL Tasman submits a review of EAPL's gas forecasts for the MSP

23 June 2003	APT further submission on the impact of the Epic Decision on the Draft Decision by the ACCC
July 2003	APT submits revised Access Arrangement Information to ACCC
17 July 2003	ACCC seeks public consultation on revised volume forecasts for the MSP
13 August 2003	AGL Submission on the ACCC revised volume forecasts
18 August 2003	TXU Submission on the ACCC revised volume forecasts
Present	Some 9 months after the NCC issued its final recommendation to the Minister that coverage of the MSP not be revoked, the Minister has still not issued his final decision.

Appendix B

Time periods from Draft Access Arrangement to Final Access Arrangement

1. **Submission of a draft Access Arrangement** (section 2.2 of the Code) - 90 days, from the date a pipeline is covered, for the Service Provider to submit a proposed Access Arrangement together with the relevant Access Arrangement Information to the Regulator. Section 2.23 provide that if a Service Provider fails to submit a proposed Access Arrangement within 90 days of coverage of the relevant pipeline, the Regulator may draft and approve its own Access Arrangement.

2. **Public consultation** (section 2.10 of the Code) - The Code envisages a public consultation process. Section 2.21(a) requires that there be at least 28 days between notification of the draft Access Arrangement and the last date for receiving submissions.

3. **Draft decision by the Regulator** (section 2.13 of the Code) - The Code requires the Regulator to provide a copy of its decision to the Service Provider and to any person who made a submission. The Regulator must provide a copy of the draft Access Arrangement to any person who requests a copy within 7 days of their request (section 2.11 of the Code).

4. **Submissions on draft decision** (section 2.15 of the code) - The Code requires the Regulator to consider any submissions received from the Service Provider or person who made submissions on the draft Access Arrangement submitted by the Service Provider within a timeframe specified by the Regulator. Section 2.21(b) requires that there be at least 14 days between notification of the draft decision and the last date for receiving submissions. However, the Code does state that the Regulator is not required to consider any submission received after the timeframe it specifies.

5. **Decision by Regulator** (section 2.16 of the Code) - the Code requires the Regulator to make a final decision which:

   (a) approves the Access Arrangement; or

   (b) does not approve the Access Arrangement and states the amendments (or the nature of the amendments) which would have to be made in order for the Access Arrangement to be approved. In that case, the Code requires the Regulator to specify a timeframe in which the Access Arrangement must be resubmitted. Section 2.21(c) provides that there must be a period of at least 14 days between the Regulator's decision and the time by which the Access Arrangement must be resubmitted; or

(c) approves a revised Access Arrangement submitted by the Service Provider which the Regulator is satisfied incorporates the amendments specified by the Regulator in its draft decision.

6. **Service Provider to submit revised Access Arrangement** (section 2.18) - where the Regulator decides not to approve the Access Arrangement under section 2.16(a), the Service Provider must submit a revised Access Arrangement to the Regulator by a specified date which is at least 14 days from the data of the Regulator's decision (2.21(c) of the Code). If this revised Access Arrangement incorporates the amendments specified by the Regulator, the Regulator must approve the revised Access Arrangement (section 2.19 of the Code).

7. **Regulator to draft and approve Access Arrangement** (section 2.20) - If the Service Provider fails to submit a revised Access Arrangement by the date specified by the Regulator (which is at least 14 days from the date of the Regulator's decision) or the Service Provider fails to incorporate such amendments as are satisfactory to the Regulator, the Regulator must issue draft and approve its own Access Arrangement.