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29 September 2003

Mr Tony Hinton
Presiding Commissioner
Gas Access Regime Review
Productivity Commission
LB2, Collins Street East
MELBOURNE VIC 8003

Dear Commissioner

BHP Billiton Appearance at the Productivity Commissions Public Hearing is to the Review of the Gas Access Regime on 19 September

BHPB would like to thank the Productivity Commission (the Commission) for the opportunity to present on the Review of the Gas Access Regime. The purpose of this letter is to follow up on a few issues we raised in our presentation. We trust it will assist the Commission in its review of the Gas Access Regime.

Coverage

The Coverage Test

BHPB believes that the current coverage test is appropriate and effective.

A number of submissions have suggested that the existing coverage test be amended particularly with respect to criteria a)

that access (or increased access) to services provided by means of the pipeline would promote competition in at least one market (whether or not in Australia), other than the market for the services provided by means of the pipeline.

In our view, the suggested changes, primarily being to change the threshold for the level of competition created in the related market(s) seek to inappropriately alter the balance of the entire coverage test. Moreover, the focus on the threshold for the level of competition created in the related market(s) also appears to reflect a misunderstanding of the dual role of the Gas Code.

The real benefits from coverage are two-fold: first, the creation of efficient pricing of downstream monopoly pipeline infrastructure; and secondly, permitting or increasing the level of supply and retail competition that results from well defined non-discriminatory access. Thus, as was emphasised in both our submission and that of The Allen Consulting Group, the Gas Code has two purposes: first, preventing the owners of the downstream infrastructure that have substantial market power from charging prices above the efficient price; and secondly, to facilitate non-discriminative third party access, and hence competition in related markets. A focus on the threshold for the level of

competition created in the related market(s) is directed only to the second of these purposes, and is also inconsistent with an overall objective for the Gas Access Regime of encouraging economic efficiency.

BHPB considers that the current coverage test, as applied in practice, has selected only those facilities for which the prospect for either monopoly pricing or the creation of unreasonable barriers to third party use are sufficiently important to warrant regulation under the Gas Code.

Experience to Date

Some submissions have asserted:

- a) That the number of coverage revocations progressed since 1997 is in some way a demonstration of the failure of the Regime;
- b) That the fact that a number of recent greenfield projects are not currently covered is also a failure of the Regime.
- c) That pipeline developers are only building pipelines with limited capacity in order to make coverage a non-issue.

Taking each one at a time.

In our view the number of revocations shows that the application of the Code is being refined to significant pipelines that clearly meet all four coverage criteria. The NCC has taken a very pragmatic approach to revoking coverage from what are primarily small region pipelines.

However, the failure of the Eastern Gas Pipeline to meet the coverage test and the revocation of coverage from the Parmelia Pipeline clearly shows that significant systems can be free from coverage and that the current coverage criteria does not automatically mean that all significant pipelines are covered. Only significant systems that have monopoly power remain covered. Any pipeline is free to seek revocation of coverage if it believes it no longer satisfies all for criteria defined in section 1.9 of the Code.

In our view the development of pipelines, that developers believe shall not be subject to coverage, is a clear indication that the current coverage test is fully understood and that pipelines can be sanctioned and financed under the current regime. Rightly there is still the option for a party to seek coverage in the future should market circumstances change.

The assertion by some that the regime means that pipelines are only being sized to meet the capacity reservations of foundation shippers is not supported by the evidence. Both the SEAGAS and the Tasmanian Gas Pipelines (TGP) were sized and committed when the coverage test and application of the Code to covered pipelines was well known. The SEAGAS pipeline has a fully compressed capacity of 125 PJ/pa effectively doubling delivery capacity into the South Australian market. It can be expected that the market will take a long time to double in size. ABARE¹ projects that South Australian demand will increase by 60% between 2000/01 and 2019/20. The TGP has a fully compressed capacity of 60 PJ/pa. ABARE projects that natural gas consumption in Tasmania will be around 8 PJ/pa in 2004/05 and grow to 20 PJ/pa by 2019/20. Based on ABARE's projections, the capacity of the TGP is not going to restrict supply to Tasmania for a long time to come.

¹ Source: Australian Energy - National and State Projections to 2019-20 ABARE report for the Ministerial Council on Energy - June 2003

Negotiate/Arbitrate

The Transmission Pipeline sector has proposed that the current access arrangement system for covered pipelines be replaced by a negotiate arbitrate model. Under this model each access seeker would separately seek to negotiate acceptable pipeline access packages failing a negotiated outcome the matter would be settled by arbitration. In BHPB's view any negotiation with a pipeline, that by definition, has substantial market power is almost certain to fail. We have direct experience of trying to negotiate access with the owners of existing downstream pipeline systems that have substantial market power. On each occasion those negotiations have failed, either because time ran out and other arrangements had to be made to meet our customers needs or because the owner of the infrastructure simply refused to engage in any meaningful negotiations.

In addition to the basic problem of the pipelines market power, we doubt that a dominant retailer in a market would have any incentive to take a negotiation with a pipeliner to arbitration. They would simply be going to the expense (both monetary and managerially) of an arbitration for what should be a cost pass through component of the delivered gas price. Dominant retailers are present in the NSW, ACT, South Australian and West Australian markets. A single retailer in these markets generally supplies all but the very largest end users.

In addition, if the entity that owned a retailer also had interests in any transmission pipelines, then the motivation to take a negotiation to arbitration would be even lower. In particular, that entity would have to assess the benefits from obtaining a better access price for its retail activities against the risk of the arbitration setting an adverse precedent for its own negotiations (as a pipeline owner) with access seekers. Moreover, there is no need for the retail and pipeline interests to be in the same market. In the normal course of events, it would be expected that the potential gains for an entity's retail business would be swamped by the potential losses for the entity's pipeline business – and no arbitrations would ever occur. It is noted that most of the major gas retailers in Australia have substantial interests in major transmission pipelines.

Arbitration does not deliver certainty of outcome, one of the key elements that the pipeline industry has stated previously that it desires. Rather arbitration puts a set of facts in the hands of a judicial or semi-judicial body and on the basis of the facts presented the arbitrator makes a ruling, that in most cases cannot be appealed except due to fraud or error. From experience BHPB knows that arbitrations and preparing for them are expensive and very time consuming exercises.

Gas Specific Regime and Ring Fencing

BHPB fully supports a gas pipeline specific regime rather than having gas pipelines fall under the general provisions of Part IIIA of the Trade Practices Act. As described in detail in our initial submission the Code was the outcome of extensive negotiation by all relevant stakeholders.

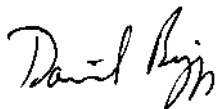
One of the specific issues addressed in the Code that is not addressed in Part IIIA is ring fencing. Ring fencing provisions in the downstream gas industry are essential as there are very high levels of cross ownership and vertical linkages between the monopoly elements of the industry and the elements that are potentially contestable. Given the small size of the Australian market this situation is probably inevitable.

As detailed in our initial submission we believe that the ring fencing provisions of the Code are appropriate although the right of a regulator to pierce the corporate veil of non-transportation associate contracts could be clarified. BHPB's concern is that some regulators have not had the courage to pursue and seriously act upon breaches of the ring fencing provisions when they have been notified to them. If there is any legal impediment to regulator's being able to act then this must be rectified. It is BHPB's strong belief that in some markets where we have tried to compete that the Codes ring fencing provisions have been breached and that competition has been damaged as a result of those breaches.

We strongly encourage the Commission to look at the issue of ring fencing in detail.

Please feel free to contact me if you require any further clarification.

Yours sincerely

A handwritten signature in black ink, appearing to read "David Biggs". The signature is written in a cursive, slightly slanted style.

David A J Biggs

Vice President Commercial