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16 April 2004

Gas Access Regime Inquiry
Productivity Commission
LB2, Collins Street East

- *MELBOURNE VIC 3003*

Dear Sir

- *REVIEW OF THE GAS ACCESS REGIME*

Western Power appreciates the opportunity to submit the attached submission to the Productivity Commission in response to the invitation to participate in its inquiry into the Gas Access Regime.

Western Power has operations across Western Australia, and owns about 56 per cent of electricity generation capacity in the State, including four major power stations. It operates around 1750 MW of gas fuelled generating plant connected to its South West Interconnected System, and supplies gas into privately owned power stations in the Pilbara and regional locations.

The State Energy Commission of Western Australia (SECWA) and its successor, Western Power, have played a key role in the development of the natural gas supply industry in the State, in particular, the delivery of gas from the North West Shelf through the Dampier to Bunbury Natural Gas Pipeline (DBNGP).

Western Power's submission concerning the Gas Access Regime is made in the regulatory context of the historical ownership of the DBNGP, and the recent experience concerning Epic Energy's proposed access arrangement for the DBNGP. In summary:

- SECWA built the DBNGP in 1984;
- SECWA operated the DBNGP until 1995;
- SECWA built gas fired generators and converted thermal generating plant to gas;
- Ownership of the DBNGP transferred to Alinta Gas in 1995;
- The DBNGP was sold to Epic Energy in 1998;
- Epic lodged its access arrangement in 1999;
- Final determination of the DBNGP access arrangement occurred in December 2003.

During the four years of the DBNGP regulatory process there has been a significant increase in demand for electricity in the State, particularly for summer air conditioning, which has led to a marked increase in gas demand from the DBNGP by peaking generating plant.

Over this period, the capacity of the DBNGP has not expanded to meet the demand for additional full haul transportation requirements (apart from the installation of two compressor stations). As a result of the current DBNGP sale process, there is continued uncertainty surrounding new capacity development on the DBNGP. It is considered unlikely that the DBNGP will be expanded before 2006.

It is Western Power's view that the regulatory experience in Western Australia has proven to be expensive, time consuming and in the case of the DBNGP, has failed to deliver a satisfactory outcome. In the last ten years, there has been three changes of regulatory regimes for the DBNGP:

- Gas Transmission Regulations (GTR) 1995-1998;
- Transitional (Post DBNGP Sale) Regulations 1998-2003;
- Access Arrangement from 2004.

There are several major disputes concerning access arrangements for DBNGP shippers. The Access Arrangement is currently the subject of several challenges to the Gas Review Board. Epic is in dispute with its GTR contract shippers concerning statutory pricing since 2000.

The Economic Regulation Authority (ERA) of Western Australia recently granted Epic an extension of time for it to make submissions concerning revisions to the first Access Arrangement (finalised in December 2003), for the next access period commencing in 2005.

Western Power believes that a pipeline owner should have the opportunity to earn a commercial return after recovering the efficient costs of operating the pipeline. However, this principle should not extend to the pipeline owner being able to recover an inflated purchase price that is substantially above the asset valuation as determined by the regulatory process and the pipeline access code.

Western Power supports the concept of two levels of regulatory coverage: a tightly regulated access regime for pipelines such as the DBNGP, and a light handed monitoring approach under proscribed conditions as suggested in the PC draft report into the Gas Access Regime.

In the case of the DBNGP, Western Power believes that a negotiated outcome with agreement by a new owner to expand capacity is the preferred way forward for determining pipeline access arrangements. New contractual arrangements would be based on general commercial terms and conditions that also form the basis of a regulated access arrangement. Western Power believes this to be a suitable access model for regulation of the DBNGP.

Western Power has reviewed in detail the draft report concerning the Gas Access Regime, and has documented for your consideration its findings in the enclosed submission.

Yours sincerely

M D CHATFIELD
GENERAL MANAGER

STRATEGIC PROJECTS

WESTERN POWER CORPORATION

Productivity Commission Review

of the

Gas Access Regime

Submission on Draft Report

16 April 2004

A Executive Summary

1. In recent years and indeed since the introduction of the Gas Access Regime, the Western Australian market for gas transmission has been troubled by uncertainty, delay and costly disputes. There has been little in the way of satisfactory outcomes within the market.
2. Western Power's ("**WPC's**") view is that it is unlikely that the sole cause of these problems is the Gas Access Regime. Rather, in Western Power's experience with the Dampier to Bunbury Natural Gas Pipeline ("**DBNGP**"), the problems have resulted from:
 - (a) the intersection of the privatisation of the DBNGP with the Gas Access Regime, including the unique difficulties encountered with Epic Energy in relation to its refusal to expand the DBNGP on the basis of the price it paid for the DBNGP and applicable tariffs; and
 - (b) the transition from the statutory access regimes previously applying to the DBNGP to the Gas Access Regime.
3. Epic Energy has been plagued by financial difficulties since the time of its purchase of the DBNGP. These financial difficulties have undoubtedly led to its claimed inability to, or its refusal to, expand the DBNGP, as well the Supreme Court action that prolonged the access arrangement approval process.
4. The legal position was less than clear during the period commencing when the (majority of the) Gas Access Regime took effect in Western Australia on 1 January 2000 and ending with the approval of an access arrangement for the DBNGP from 13 January 2004. This lack of clarity has been exploited, leading to the difficulties encountered by users in pursuing access disputes under the DBNGP.
5. In light of these factors, it is almost impossible in Western Australia to quantify the specific effect that the Gas Access Regime has had on the gas transmission market and upstream and downstream markets.
6. There are however, in WPC's opinion, a number of important issues that have arisen since the implementation of the Gas Access Regime which must be explored.
7. The gas transmission market in Western Australia is characterised by a single pipeline connecting the major gas basin located in the north-west of the State, with the majority of industry which is located in the south-west of the State. This means that Epic Energy, as the owner of that pipeline, possesses significant market power.
8. WPC considers that the Gas Access Regime focuses on preventing service providers from exercising their market power by charging monopoly rents for spare capacity but does not adequately address issues of expansion.
9. Epic Energy has exercised its market power and increased its negotiating leverage by refusing to expand the capacity of the DBNGP. In WPC's experience, neither the statutory access regime previously applying nor the Gas Access Regime have adequately dealt with Epic Energy's refusal to expand the capacity of the DBNGP.

10. Epic Energy's exercise of its market power in this manner has caused the imbalance between demand for capacity and supply of capacity to worsen, in what was already a capacity constrained pipeline.
11. WPC emphasises that it has been seeking an expansion of the DBNGP for a number of years. WPC is willing to fund the expansion in order to secure additional capacity, but despite WPC's willingness to make a financial contribution to the expansion, Epic Energy has steadfastly refused to expand the DBNGP.
12. It is critical that a user that is seeking an expansion of a pipeline and is willing to fund the expansion is able to obtain an expansion. It is clear from section 6 of the Gas Code that this is an aim of the Gas Access Regime, but so far the Gas Access Regime has failed to deliver on this aim.
13. Ensuring that it is possible to achieve user-funded expansions of capacity-constrained pipelines is extremely important and users rights in this regard warrant improved protection under the Gas Access Regime.
14. WPC notes that the determination of a reference tariff using the 'building block approach' represents an extremely necessary protection in terms of regulating the price for access to spare capacity.
15. However, it goes very little distance in assisting a user to obtain developable capacity in a capacity constrained pipeline.
16. Due to the strong monopoly characteristics still present in the Western Australian gas transmission market, together with the impending resale of the DBNGP and the factors set out above, WPC does not believe that at present there is any justification for moving towards a "light-handed" regime for the DBNGP which would erode the rights of users and further destabilise upstream and downstream gas-consuming markets.
17. This would have a negative effect on the Western Australian economy.
18. WPC has a number of concerns in relation to the monitoring option. In particular, the two proposed coverage tests risk introducing a high level of discretion and uncertainty into coverage decisions.
19. By introducing additional discretion, further potential for dispute within the Gas Access Regime will also be introduced. This will further complicate and increase the cost of the process, having the effect of further delaying the achievement of the objects of the Gas Access Regime.

B Introduction

20. This is Western Power Corporation's ("WPC's") submission to the Productivity Commission on its Draft Report on the Gas Access Regime.
21. This submission is structured as follows:
 - (a) Part C contains background information about:
 - (i) WPC and its business of electricity generation;
 - (ii) WPC's requirements for natural gas and other fuels;
 - (iii) Western Australia's natural gas resources;
 - (iv) Western Australia's gas transmission pipelines;
 - (v) WPC's use of the DBNGP under previous third party access regimes; and
 - (vi) the approval of an access arrangement for the DBNGP under the National Third Party Access Code for Natural Gas Pipeline Systems ("Gas Code");
 - (b) Part D contains WPC's submissions in relation to the Productivity Commission's draft findings and draft recommendations in the Draft Report on the Gas Access Regime;
 - (c) Part E contains WPC's submissions in relation to the Gas Access Regime on matters other than those addressed in the Productivity Commission's draft findings and draft recommendations; and
 - (d) Part F contains WPC's submissions in relation to the Productivity Commission's information requests.

C Background

C.1 Western Power Corporation's Business

22. WPC is a statutory corporation that was established pursuant to the *Electricity Corporation Act 1994 (WA)* on 1 January 1995 from the electricity division of the State Energy Commission of Western Australia ("SECWA").
23. WPC operates an electricity generation, transmission, distribution and retailing business from premises situated at 363 Wellington Street, Perth.

24. WPC:
- (a) generates, acquires, exchanges, transports, distributes, markets and otherwise supplies electricity to commercial, industrial and residential customers throughout Western Australia;
 - (b) undertakes, maintains and operates the facilities and equipment required for these activities; and
 - (c) develops technology, software and other intellectual property relating to these activities.
25. In 2002-2003, WPC:
- (a) was servicing approximately 847,000 industrial, commercial and residential customers in Western Australia; and
 - (b) owned approximately 56% of the electricity generation capacity in Western Australia, the remainder being owned by private industry.
26. WPC is the principal generator, transmitter, distributor and retailer of electricity in Western Australia. In 2000/01, electricity generation in Western Australia totalled 82.7PJ (23,000GWh), 56% of which was generated by WPC.¹ Private producers throughout Western Australia generated the remainder primarily to supply their own or individual customers' mining, mineral processing or other operations.

C.2 Generating electricity

27. WPC owns six major power stations (at Kwinana, Muja, Collie, Pinjar, Mungarra and Cockburn) and 26 smaller regional stations with a total capacity of 3280 megawatts. **"Power stations"** means a collection of one or more individual generating units on a given site.
28. WPC operates and maintains all except one of the major power stations – Collie power station is privately operated and maintained.
29. WPC also obtains electricity from gas-fired cogeneration facilities at Tiwest and Edison Mission, both located at Kwinana, and from South West Cogeneration located at Worsley.
30. Electricity is transported via 2 major interconnected networks – the South West Interconnected System ("**SWIS**") and the North West Interconnected System ("**NWIS**") – as well as through smaller regional town distribution systems.
31. The SWIS supplies the south west corner of Western Australia and communities north to Kalbarri and east to the Goldfields.
32. The NWIS supplies major towns in the Pilbara region including Port Hedland and Karratha.

¹ *Energy in Western Australia*, Government of Western Australia, February 2003.

33. WPC's 26 smaller regional power stations supply power to remote towns throughout Western Australia outside the interconnected systems.
34. At all times, the electricity grid must always be maintained in balance (ie. generation must match load).
35. WPC's production and distribution statistics from 1997 to 2003 are set out in the following table:

Production and Distribution	2002-2003	2001-2002	2000-2001	1999-2000	1998-1999	1997-1998
Electricity Generation						
Generation – thermal, diesel, wind (GWh)	12,871.3	12,392.0	12,167.3	12,344.9	12,158.1	11,810.3
Used in works (GWh)	837.7	826.00	828.5	853.6	803.8	776.6
Purchased (GWh)	1,502.5	1557.0	1,698.9	1,134.7	1,072.7	1,109.0
Sent out (GWh)	13,536.0	13,123.0	13,037.7	12,626.0	12,427.0	12,142.7
Cold weather maximum demand (MW generated)	2,308	2,223	2,243	2,156	2,126	2,186
Hot weather maximum demand (MW generated)	2,719	2,473	2,538	2,508	2,331	2,268
Peak load interconnected system (MW generated)	2,719	2,473	2,538	2,508	2,331	2,268
Interconnected generation capacity winter capability (MW)	3,172	3,172	3,150	3,150	3,210	2,844
Thermal efficiency for kWh generated (%)	31.0	31.4	31.3	31.6	32.4	30.1
Fuel Consumption Used for Generation						
Coal ('000 tonnes)	4,931	4,718	4,605	4,729	4,365	4,389
Distillate and other fuel oils (tonnes)	64,791	60,821	60,647	62,807	69,913	65,813
Gas (TJ)	38,597	36,038	38,284	36,061	41,039	43,750

Distribution – Interconnected System						
Sent out (GWh)	12,879.0	12,498.3	12,438.8	12,047.1	11,835.8	11,542.7
Line loss (GWh)	1,016.7	997.4	1,000.0	956.6	968.1	1,021.8
Sold to customers (GWh)	11,862.3	11,500.9	11,438.8	11,090.5	10,867.7	10,520.9
Distribution – Non Interconnected System and Pilbara						
Sent out (GWh)	657.0	625.0	598.9	578.9	591.0	600.0
Line loss (GWh)	44.0	44.6	41.0	34.2	52.0	58.0
Sold to customers (GWh)	613.0	580.4	557.9	544.7	539.0	543.0
Customer Accounts at 30 June	847,058	828,113	810,568	794,746	775,602	758,792

36. A range of factors affect which of WPC’s generating assets (coal-fired, gas-fired and other) is “dispatched” (ie. used for generating electricity) on a given day. Some factors which affect this are: plant availability due to scheduled and unscheduled maintenance; timing and nature of load; strategic issues associated with managing WPC’s various long-term gas and coal contracts; and, capacity availability in the Dampier to Bunbury Natural Gas Pipeline (“**DBNGP**”). Similarly, a range of factors determines which gas-fired generating units are dispatched on a given day.
37. Generating units can be classified as “**base load**”, “**mid-merit**” and “**peaking**”. Base load generating units (which predominately comprise coal-fired thermal units like those at Collie and Muja and gas-fired cogeneration units like those of Tiwest and BP Mission) are dispatched first. Then as the electricity load increases during the day, mid-merit plant (such as the gas-fired thermal units at Kwinana) is dispatched. Finally, peaking units (such as the gas turbines at Pinjar) are used to meet peak load during the day.

C.3 WPC’s fuel consumption

38. Fuel accounts for about 50% of WPC’s generating costs and represents the largest input into WPC’s cost base. WPC consumes various fuels to generate electricity at its power stations including natural gas, coal, fuel oil and distillate. WPC generates a small amount of electricity using wind and other renewable sources.
39. The following table sets out SWIS facilities and their fuel source in 2002-2003:

Generating Plant	Fuel	Capacity (MW)	Acquired or Commissioned	Energy Generated 2002 – 2003 (GWh)
Collie	Coal	330	1999	25359.4
Muja A & B	Coal & Heavy Fuel Oil	240	1965	1473.7
Muja C	Coal & Heavy	400	1981	1948.3

Generating Plant	Fuel	Capacity (MW)	Acquired or Commissioned	Energy Generated 2002 – 2003 (GWh)
	Fuel Oil			
Muja D	Coal & Heavy Fuel Oil	400	1985 – 86	3,029.8
Kwinana A & C	Coal & Gas	640	1970 – 78	1,974.7
Kwinana B	Gas	240	1970 – 73	359.1
Kwinana Gas Turbine	Gas & Distillate	21	1972	0.8
Geraldton Gas Turbine	Gas & Distillate	21	1973	0.1
Kalgoorlie Gas Turbines	Distillate	62	1984 – 90	0.9
Mungarra Gas Turbine	Gas	112	1990 – 91	287.0
Pinjar Gas Turbines	Gas & Distillate	586	1990 – 96	484.6
Wellington Dam	Hydro	2	1992	-
South West Cogeneration (50% Joint Venture Share)	Gas	6	2000	493.4
Tiwest	Gas	36	1999	144.1
Albany Wind Farm	Wind	22	2002	68.5
Total		3,172		12,624.4

40. WPC is a major consumer of natural gas in powering its power station gas turbines, thermal plant and cogeneration plant. WPC uses gas to generate approximately 30% of its electricity in the SWIS.
41. WPC's fuel consumption is driven largely by electricity demand, which does not occur at a constant level throughout a 24-hour period. Electricity consumption is higher during the day than at night, and tends to show both a morning peak and an evening peak. Electricity consumption is also higher in summer, due primarily to customers' air conditioning requirements.

C.4 Gas sources

42. The majority of natural gas used by WPC is from the Carnarvon Basin in the north-west of Western Australia. The Carnarvon Basin produced 58% of the natural gas in Australia in 2001 (720 PJ).²
43. The only other basin from which Western Power is able to obtain gas is the Perth Basin, which is located along the west coast of Western Australia. Its production in 2001 was 11 PJ, which is equal to 1.5% of the gas produced from the Carnarvon Basin.³
44. As the table set out at paragraph 35 shows, WPC's annual natural gas requirements are more than three times the entire annual production of the Perth Basin.
45. It is therefore critical that WPC is able to obtain gas from the Carnarvon Basin and transport that gas approximately 1400km from the north-west of Western Australia to the south-west of Western Australia, where almost all of WPC's generating plant and demand is located.

² Productivity Commission 2003, *Review of the Gas Access Regime*, Draft Report, Canberra, p. 7.

³ Productivity Commission 2003, *Review of the Gas Access Regime*, Draft Report, Canberra, p. 7.

C.5 Gas transmission pipelines

46. Two transmission pipelines supply gas to the south-west of Western Australia:
- (a) the Parmelia Pipeline; and
 - (b) the DBNGP.

C.6 The Parmelia Pipeline

47. The Parmelia Pipeline (“**PP**”) is 445km long and runs from Dongara on the mid-west coast of Western Australia to Perth and Pinjarra in Western Australia’s south west.
48. It is owned and operated by CMS Gas Transmission of Australia.
49. It was listed in Schedule A of the Gas Code as a covered pipeline.
50. An access arrangement for the PP was approved by the Office of Gas Access Regulation (“**OffGAR**”) in December 2000.
51. The PP’s coverage was revoked by the Western Australian Minister for Energy in March 2002 on the application of its owner and operator.
52. WPC utilises the PP as a bypass transport service for the lower portion of the DBNGP by which it delivers only a limited amount of gas to the Kwinana Power Station.
53. The PP does not have the capacity to deliver sufficient gas to service WPC’s present and future requirements.

C.7 The DBNGP

54. The DBNGP is 1845km long and runs from Dampier in the north west of Western Australia to Bunbury in the south west of Western Australia.
55. The SECWA (as it was then) commissioned the DBNGP. It began operating in 1984. SECWA, and then one of its successor-entities, Gas Corporation (trading as AlintaGas), owned the DBNGP until it was privatised on 25 March 1998.
56. The Epic Energy group of companies (“**Epic Energy**”) purchased the DBNGP, and continues to own and operate it. However Epic Energy commenced a formal sale process in respect of the DBNGP in September 2003.
57. On 13 January 2004 an approved access arrangement took effect for the DBNGP under the Gas Code.
58. Prior to the approved access arrangement taking effect under the Code, the DBNGP was subject to the following statutory third party access regimes:
- (a) from 1 January 1995 to 25 March 1998 — the *Gas Transmission Regulations 1994 (WA)* (“**GTR**”), having effect under the *Gas Corporation Act 1994 (WA)*; and
 - (b) from 25 March 1998 to 13 January 2004 — the *DBNGP Access Manual* dated 10 March 1998 (“**access manual**”) and *Dampier to Bunbury Pipeline*

Regulations 1998 (WA) (“DBPR”), first having effect under the Dampier to Bunbury Pipeline Act 1997 (WA) and then having effect under the Gas Pipelines Access (Western Australia) Act 1998 (“GPA Act”).

59. WPC entered into several substantial access contracts under the GTR. Most of those contracts still currently operate.
60. WPC entered into several smaller access contracts under the DBPR and the access manual. These contracts also still operate.
61. Section 21 of the *Petroleum Pipelines Act 1969 (WA)* provides a minimal regime for third party access to certain petroleum pipelines however it has never applied to the DBNGP.

C.8 WPC as a shipper on the DBNGP

62. The DBNGP is the only pipeline through which gas from the North West Shelf (Carnarvon Basin) can be transported to south west Western Australia.
63. The DBNGP has an annual physical average throughput capability of roughly 600 TJ/d. This consists of roughly 100 TJ/d of interruptible (non-firm) capacity, with the balance of roughly 500 TJ/d being firm capacity.
64. WPC is a major user of the DBNGP, transporting an annual average of roughly 120 TJ/d through the DBNGP.
65. WPC depends upon security of gas transmission to be able to power its gas-fired plant and meet the needs of its customers. As demonstrated in August 2003 when gas flow through the DBNGP was curtailed for compressor plant maintenance, the interruption of gas flowing through the DBNGP increases the risk of substantial disruption to WPC’s generating activity and the extent to which WPC is forced to constrain its customers’ power usage. An interruption of gas transmission to WPC would potentially result in substantially increased fuel costs (if fuel oil or diesel must be burned instead at short notice) and possible electricity black-outs (if load shedding is required).
66. On 18 February 2004 WPC was forced to implement power use restrictions in the SWIS under the *Energy Operators (Powers) Act 1979* due to Epic’s inability to transport sufficient gas for use in WPC’s gas-fired peaking plant.
67. WPC’s business is to generate electricity to meet the demands of its 847,000 customers. Because of this, WPC is different from other industrial gas users, who are able to predict their patterns and amount of gas consumption on a day with accuracy and, to the extent that such predictions are wrong, are able to control their consumption with relatively minor effects on their business. In comparison, WPC’s gas consumption is linked to its electricity customers’ demand (which in turn is affected by factors substantially outside WPC’s control, for example the weather), so WPC often may not be able to predict the pattern or amount of its gas consumption with precision. On any day WPC may have excess or insufficient gas transmission capacity despite its best endeavours to nominate for capacity accurately and despite it acting as a reasonable and prudent power system operator.

68. Currently, the control rooms of WPC and Epic Energy typically work very closely together in managing WPC's requirements together with the requirements of other users. WPC is a major shipper with some discretion as to the location of where it takes gas from the DBNGP. Epic is able to work with WPC to utilise this variability of load to maximise efficient utilisation of the DBNGP.

C.9 Requirements for Further Capacity

69. WPC requires capacity in the DBNGP in addition to that which it has under its existing gas transmission contracts. This capacity required by WPC is of 2 types:
- (a) that which it requires immediately to generate electricity to meet the demands of its 847,000 customers; and
 - (b) that which it will require in the future both in place of capacity it will lose as a result of the eventual expiry of its existing gas transmission contracts and as a result of increased demand in the future.
70. Since May 2000 WPC has been in regular communication with representatives of Epic Energy with a view to obtaining further capacity in the DBNGP for WPC and with a view to obtaining information as to available capacity in the DBNGP both at present and in the future.
71. Apart from the developments listed in paragraphs 73 and 74 below, those efforts have been largely unsuccessful.
72. On 27 May 2003 WPC lodged a notice of dispute with the Western Australian Gas Referee pursuant to regulation 30 of the *Gas Referee Regulations 1995* (WA) alleging that Epic Energy had failed to comply with its statutory obligations with respect to providing DBNGP capacity to third parties and expanding the DBNGP.
73. In June 2003, Epic Energy finally provided some limited information to WPC, being annual reports and forecasts prepared by Epic Energy as at January 2002 and January 2003. Epic Energy had been required by law to prepare and make available such reports and forecast, looking forward over a five year period, since March 1998.
74. Since late 2003 Epic Energy has entered into a series of very short term, small transmission contracts with WPC.
75. These developments fall well short of WPC's major gas transmission capacity and gas transmission capacity development requirements in respect of the DBNGP.

C.10 WPC's use of natural gas will increase

76. WPC expects its gas consumption to increase over the coming years.
77. Demand for primary energy in Western Australia has grown at an average rate of 3.5% per year from around 301 petajoules ("PJ") in 1975/76 to 719 PJ in 2000/01.⁴ In 2000-01 natural gas had the highest share of primary energy use in Western Australia

⁴ *Energy in Western Australia*, Government of Western Australia, February 2003.

- at 51%, followed by oil and condensate (31%), coal (16%) and renewable energy sources (2%).⁵
78. Unlike the use of oil and condensate (which has remained almost constant), the use of natural gas in Western Australia has increased dramatically over the past 25 years from around 31 PJ in 1975/76 to 366 PJ in 2000/01 and the trend is expected to be sustained, driven primarily by gas demand for resource processing and power generation.⁶
79. In electricity generation, natural gas was the most common fuel used (by WPC and private generators cumulatively) in 2000-01.⁷ Gas represented approximately 54% of the total fuel used, followed by coal at 42%.
80. Natural gas is likely to remain the predominant fuel used in electricity generation in Western Australia. Past trends and the interest in the development of new resource projects based on or fuelled by natural gas is an indicator that natural gas consumption will continue to rise for both direct use in processing and as a fuel for electricity generation.⁸ For example, a new 240 MW combined cycle gas turbine unit is currently being considered for construction at Cockburn as part of the State's ongoing power procurement process.
81. As noted in the Draft Report, "Natural gas electricity generation has characteristics that give it advantages over other fuels in meeting peak and some intermediate load".⁹ It is certainly the case that electricity demand trends in Western Australia are resulting in an increased need for gas-fired peak generators.
82. If WPC does not have access to natural gas, WPC cannot generate sufficient electricity in a commercially acceptable manner from fuels other than natural gas to meet its customers' electricity load. WPC's current and future natural gas requirements mean that the approved access arrangement for the DBNGP is of great importance to WPC and to the State of Western Australia.

C.11 Approval of the DBNGP Access Arrangement

83. Section 95(3) GPA Act required Epic Energy, within 9 months of the commencement of the GPA Act on 9 February 1999, to submit to the Regulator a proposed access arrangement and access arrangement information for the DBNGP for the purposes of the Code.
84. The following indicates the actual timeline for the access arrangement process:
- (a) 15 December 1999 – Epic submits its proposed access arrangement, access arrangement information and associated documents ("Access Arrangement documentation") to the Regulator;
 - (b) Public submissions (two rounds);

⁵ *Energy in Western Australia*, Government of Western Australia, February 2003.

⁶ *Energy in Western Australia*, Government of Western Australia, February 2003.

⁷ *Energy in Western Australia*, Government of Western Australia, February 2003.

⁸ *Energy in Western Australia*, Government of Western Australia, February 2003.

⁹ Productivity Commission 2003, Review of the Gas Access Regime, Draft Report, Canberra, p. 18.

- (c) 17 March 2000 – Regulator announces Epic required to submit revised Access Arrangement documentation;
- (d) 17 August 2000 – Epic submits revised Access Arrangement documentation;
- (e) 21 June 2001 – Regulator issues Draft Decision;
- (f) August 2001 – Epic filed application for Judicial Review;
- (g) 28 August 2001 – Supreme Court granted order nisi;
- (h) 23 August 2002 – Supreme Court handed down decision in relation to Epic’s application;
- (i) 2 September 2002 – Regulator called for submissions on the Court decision;
- (j) 23 May 2003 – Regulator issued final decision;
- (k) 8 August 2003 – Epic submitted revised proposed access arrangement;
- (l) 18 November 2003 – Regulator issued Supplementary Reasons and Amendment to Final Decision;
- (m) 21 November 2003 – WPC filed application in Supreme Court for judicial review of Final Decision;
- (n) 30 December 2003 – Regulator issued Further Final Decision not approving Epic’s revised Access Arrangement documentation;
- (o) 13 January 2004 – Commencement of Access Arrangement drafted by Regulator;
- (p) 30 January 2003 – 14 January 2004 – 3 parties lodged applications with the Gas Review Board seeking merits review of the Approved Access Arrangement.

D Draft Report findings and recommendations

85. WPC makes the following submissions in relation to the findings and recommendations in the Draft Report.

Chapter 2 – Australian Gas Industry

D.1 Draft finding 2.1

While transmission pipelines have natural monopoly characteristics, the market power of transmission pipeline owners is constrained by a number of factors, particularly:

- *the availability of substitutes – that is, the presence of a competing pipeline in the end market and/or of alternative fuel and energy sources;*
- *the size and concentration of users and the competitive nature of foundation contracts;*
- *the elasticity of demand for the final products, for which natural gas is an input.*

The extent to which these factors constrain market power differs across pipelines.

86. WPC submits that the crucial part of this draft finding is the last sentence: “The extent to which these factors constrain market power differs across pipelines”.

87. This means that any constraints that might exist on the market power of one or more transmission pipeline owners cannot be used as a basis for recommending a change to the Gas Access Regime that will affect all transmission pipelines.

88. For many transmission pipelines, the market power of their owners is subject to little or no constraint. This is especially so in the case of the DBNGP (see paragraphs 62 to 82).

89. As to the availability of substitutes, there is no adequate competing gas transmission pipeline bringing gas from an adequate basin servicing the south west of Western Australia (see paragraphs 42 to 45).

90. As to alternative energy sources, WPC is a generator of electricity, therefore it is not able to substitute electricity for natural gas as a householder or business might be able to.

91. As to alternative fuel sources, WPC does use coal and distillate in generating electricity (see paragraph 39), however natural gas is the only commercially and environmentally acceptable fuel for use in peaking and some mid-merit generators (see paragraphs 79 to 82). This is particularly so in the case of existing generating plant which has been constructed to use only natural gas as a fuel source, but the same commercial and environmental factors apply in respect of the construction of peaking and mid-merit generating plant in the future.

92. There is no economically suitable substitute in the short to medium term for natural gas for WPC’s installed peaking generation capacity in Western Australia. Whilst some of WPC’s gas fired plant can be run on liquids, there is a far higher operating

cost associated with utilising these alternative fuels. These undeniable financial implications would have an adverse impact on the cost of electricity and accordingly, a widespread economic effect in markets that use electricity. In addition, burning liquids is often environmentally undesirable and at times fundamentally inconsistent with existing environmental restrictions.

93. The Productivity Commission acknowledged in the Draft Report that “the propensity to substitute natural gas for alternative fuels or energy sources varies considerably across sectors and individual users”.¹⁰

94. The Productivity Commission found that:

The ability of users to substitute to alternative fuels or energy sources is limited in the short term if they have plants built to run only on natural gas (a purpose built gas-fired electricity generator) or if they have signed long term contracts for using natural gas.¹¹

95. Each of these reasons apply in respect of WPC, as well as the additional point that natural gas is the only commercially and environmentally acceptable choice for peaking generation.

96. WPC has substantial gas-fired generators and WPC has large contractual obligations in relation to the supply of natural gas.¹² If WPC was unable to obtain fuel for its gas-fired generating plant, and was forced to forego its sunk investment in the plant, the financial consequences would be disastrous. The financial consequences would be seriously compounded because WPC would be unable to take gas under its gas supply contracts.

97. WPC endorses the positions put by the Australian Competition and Consumer Tribunal (“ACCC”) and cited by the Productivity Commission that Australian Competition Tribunal decisions show that the ability to substitute energy sources for natural gas is limited:

in the past the tribunal has consistently found that gas prices are not effectively constrained by alternative energy sources and has found the product market to be a gas specific market.¹³

98. The Productivity Commission appears to have given this fact little weight in coming to its draft finding 2.1.

99. As to the size and concentration of users and the competitive nature of foundation contracts, the DBNGP began operating so long ago that foundational contracts have little relevance to WPC’s needs for gas transmission capacity. The DBNGP began operating in 1984 and was owned by SECWA, ensuring WPC was able to obtain adequate gas transmission capacity. In 1995, when SECWA was disaggregated,

¹⁰ Productivity Commission 2003, Review of the Gas Access Regime, Draft Report, Canberra, p. 34

¹¹ Productivity Commission 2003, Review of the Gas Access Regime, Draft Report, Canberra, p. 36

¹² WPC has just entered into a contract for the purchase of 700 PJ of natural gas from the North West Shelf for a period of up to 20 years extending existing arrangements which were due to expire in 2006.

¹³ Re AGL Cooper Basin Natural Gas Supply Arrangements (1997) ATPR 41-593 and Duke Eastern Gas Pipeline Pty Ltd (2001) ATPR 41-821

contracts were entered into which set out WPC's entitlements to gas transmission capacity.

100. As these contracts expire, and WPC's needs for gas transmission capacity increase, WPC is finding that it has little or no bargaining power. There are a number of large users in the south west of Western Australia, all with a critical need for gas and all competing for the limited amount of the DBNGP transmission capacity that is available.

101. As the Productivity Commission found in its Draft Report:

The bargaining power of users and owners of transmission pipelines rests on their ability to threaten not to deal with the other party. The balance of power depends on the credibility and effectiveness of each party's threat. It also reflects which party would incur the highest cost if the transaction did not take place.¹⁴

102. In circumstances where WPC has a large sunk investment in gas-fired generators and there are no alternative gas or gas transportation options, WPC cannot make a credible threat to not deal with the owner of the DBNGP.

103. The Productivity Commission noted that "Another benefit of long term contracts is that they reduce the scope for opportunistic behaviour whereby one party refuses to do business except on unreasonable terms".¹⁵ Clearly, at the time of expiration of foundation contracts, the opposite occurs: the party with the investment in the gas-fired generators or other facilities has no choice but to deal with the gas transmission pipeline owner, even where the owner imposes unreasonable terms.

104. Accordingly, WPC and its customers rely very heavily on there being an effective and fair Gas Access Regime, which ensures timely access to gas transmission capacity on reasonable terms.

105. As to the elasticity of demand for transmission pipeline services, there is very low elasticity of demand for the transmission services of the DBNGP, particularly in respect of WPC's use of the DBNGP (set out in paragraph 107 below).

106. Therefore, unless subject to an effective third party access regime, the operator of the DBNGP has a high degree of market power because it will be able to increase its prices without reducing its sales.

107. WPC makes the following submissions in regard to the four factors that influence the elasticity of gas transmission services, being a service with a "derived" demand:¹⁶

- (a) the elasticity of the end user's demand for the final product – as argued in paragraphs 90 to 98, due to WPC's substantial investment in gas-fired generating plant, its long-term gas supply contracts and the unacceptable economic and environmental consequences of not using gas for peaking and mid-merit generation, WPC's demand for gas is inelastic;

¹⁴ Productivity Commission 2003, Review of the Gas Access Regime, Draft Report, Canberra, p. 26

¹⁵ Productivity Commission 2003, Review of the Gas Access Regime, Draft Report, Canberra, p. 30

¹⁶ Productivity Commission 2003, Review of the Gas Access Regime, Draft Report, Canberra, p. 30.

- (b) the availability of substitutes for transmission services – there are no intermodal substitutes for pipeline transmission of gas in Western Australia and, as argued in paragraphs 90 to 98, for reasons including no scope for technical substitution in the short-term or medium-term, there are no acceptable fuel or energy substitutes for gas for peaking and mid-merit generation, with the result that WPC’s demand for gas and gas transmission is inelastic; and
- (c) the elasticity of supply of other inputs – WPC’s demand for the other inputs into WPC’s electricity generation are not elastic, making it essential that there be an effective third party access regime for gas transmission pipelines.

D.2 Draft finding 2.3

The market conditions facing the gas transmission and distribution sectors have changed significantly since the Gas Access Regime was introduced. In particular, participants in these sectors are increasingly responding to new opportunities that arise in an emerging competitive market. This increased contestability is expected to continue, including through greater connectivity. However, the gas market is still in transition. In this environment, a gas access regime of sorts is still warranted.

- 108. This draft finding may have some relevance in respect of the eastern States, however it is of little relevance in an analysis of the Western Australian gas transmission sector.
- 109. The Productivity Commission cited the increasing basin-on-basin and pipe-on-pipe competition in the eastern part of Australia, and the increasing interconnectivity of transmission pipelines as a basis for draft finding 2.3.
- 110. However, there has been no significant change in the market conditions facing the gas transmission sector in Western Australia since the introduction of the Gas Access Regime. There remains little or no interconnectivity between gas fields and markets, and transmission pipelines, in Western Australia and there is no significant pipe-on-pipe competition (see paragraphs 42 to 68).
- 111. Accordingly, any amendments to the Gas Access Regime must strengthen, or at least maintain, the rights of users in their dealings with service providers.
- 112. There is no justification in Western Australia for moving towards a “light-handed” regime that erodes the rights of users on the grounds that a changed gas transmission sector makes a powerful Gas Access Regime unnecessary. To do so would severely injure the Western Australian market, on the basis of changes that have occurred only in the eastern States, when the rewards of the Gas Access Regime are yet to be reaped.
- 113. The draft finding in relation to a changed gas transmission sector, which (if true at all) does not hold true for Western Australia’s gas transmission sector, cannot be used as a basis for recommending a change to the Gas Access Regime that will affect all transmission pipelines.
- 114. WPC agree that some amendments to the Gas Access Regime are needed to improve its effectiveness, but these amendments should not result in service providers being able to exert their market power against users to an even greater degree than they can at present.

115. A third party access regime for gas transmission pipelines, if structured and implemented in an effective manner, has the potential to generate significant improvements in economic efficiency in the downstream gas-consuming industries in the south-west of Western Australia, and in the Western Australian economy generally. The full benefits of the Gas Access Regime are yet to be experienced in Western Australia. This is particularly so for the DBNGP, which has only had an approved access arrangement since 13 January 2004 and even that is still subject to challenge.

Chapter 3 – Gas Access Regime

D.3 Draft finding 3.1

The Gas Access Regime is a form of price regulation based on a cost-of-service model. It is, therefore, at the more intrusive end of regulation.

116. The Productivity Commission stated in the Draft Report that:

Although the Gas Access Regime is predicated on a negotiate-arbitrate framework, there are a number of characteristics of the regime that impact on the practicality of negotiation....The Gas Access Regime has thus become price regulation of the covered pipeline services available to third party access seekers.¹⁷....The Commission considers that the Gas Access Regime is a form of price regulation of covered pipeline services available to third parties based on a cost-of-service model. On balance, the regime has inhibited commercial negotiation.¹⁸

117. WPC does not agree that it is a necessary outworking of a regime such as the Gas Access Regime that it will inhibit commercial negotiation.
118. A reference tariff is a reference point against which a service provider and a prospective user can negotiate a tariff for a non-reference service. It is more likely to be the case that if a service provider has chosen to rely solely on the reference service or services, rather than being prepared to negotiate non-reference services, it is because doing so has been to its advantage – either because of the terms of the reference service, or because refusing to negotiate a non-reference service gives the service provider more negotiating power for future negotiations. The solution to this exercise of market power by a service provider is not to relax regulation.
119. WPC supports the continued existence of a “fall-back” reference tariff under the Gas Access Regime and hopes to see more interest from service providers in the future in negotiating non-reference services.
120. WPC also notes the significant transaction cost savings for both parties where a contract is entered into for a standard service on standard terms and conditions, as were a number of WPC’s contracts under third party access regimes that existed prior to the Gas Access Regime.
121. Such savings are of great benefit to the industry, but of even greater benefit to the industry are the speed at which, and ease with which, standard form contracts can be entered into.

¹⁷ Productivity Commission 2003, Review of the Gas Access Regime, Draft Report, Canberra, p. 69

¹⁸ Productivity Commission 2003, Review of the Gas Access Regime, Draft Report, Canberra, p. 70

Chapter 4 – Is the Gas Access Regime working?

D.4 Draft finding 4.1

An industry-specific national access regime should be retained for gas transmission pipelines and distribution networks.

122. WPC endorses this finding.
123. WPC believes that with appropriate amendments to address identified deficiencies, the more prescriptive access arrangements under the Gas Access Regime are less costly overall than access directly under Part IIIA of the *Trade Practices Act 1974* (Cth).
124. WPC's view is that, because in most cases there will be a number of access seekers for each pipeline, "a generally available access arrangement for such pipelines is likely to involve lower costs than [the costs] of requiring each access seeker to seek access through the negotiate-arbitrate framework of the national access regime (Part IIIA of the TPA)."¹⁹
125. In addition, there is benefit in having a national gas access framework that accounts for the specific characteristics of the gas market.

D.5 Draft finding 4.2

The Gas Access Regime has determined terms of access to pipelines and lowered prices for gas transmission and distribution.

126. The full effects of the Gas Access Regime are yet to be experienced in Western Australia, as there has been considerable delay in the approval of access arrangements for the two major pipelines: the DBNGP and the Goldfields Gas Pipeline.
127. An approved access arrangement took effect for the DBNGP on 13 January 2004 (see paragraphs 83 and 84), and so its effects have yet to be felt, however the first third party access regime in respect of the DBNGP took effect in 1995 and certainly served to open up access to the DBNGP.
128. For some time now there has been little or no spare capacity in the DBNGP, and therefore little capacity available to be contracted at the reference tariff. Accordingly, WPC's major focus has been on obtaining developable capacity in the DBNGP and submits that the Gas Access Regime requires strengthening in relation to expansions so that this can be achieved.
129. An access arrangement has yet to be approved with respect to the Goldfields Gas Pipeline.
130. WPC submits that a third party access regime with access arrangements should be given an opportunity to operate in Western Australia, so that its effects can be judged properly. Only once the initial problems with the implementation of the Gas Access Regime have been overcome and access arrangements have been in operation for a

¹⁹ Productivity Commission 2003, Review of the Gas Access Regime, Draft Report, Canberra, p. 76-77.

period of time, will the full effects of the regime be truly felt and participants be in a position to fairly comment on all aspects of the regime.

131. The initial problems with the implementation of the Gas Access Regime were primarily due to the intersection of the Gas Access Regime with the privatisation of the DBNGP and the intersection of the Gas Access Regime with the *Goldfields Gas Pipeline Agreement Act 1994 (WA)* for the Goldfields Gas Pipeline.

D.6 Draft finding 4.3

The Gas Access Regime deters and distorts investment, possibly altering the nature and timing of pipeline projects. Pipeline constructions might be delayed, for example, or pipelines might be built 'fit for purpose'. Such alterations can delay the emergence of competition in upstream and downstream markets.

132. In Western Australia, the capacity constraints on the DBNGP and the failure of Epic Energy, the owner of the DBNGP, to expand the DBNGP in a timely manner in accordance with its statutory obligations under the third party access regime which applied prior to the Gas Access Regime are largely attributable to the intersection of relevant access regimes with the privatisation of the DBNGP.
133. Epic Energy has been plagued by financial difficulties since the time of its acquisition of the DBNGP. These financial difficulties have undoubtedly contributed to its inability to, or refusal to, expand the pipeline.
134. WPC acknowledges that a lack of investment has occurred in respect of the DBNGP largely due to the price Epic paid in the privatisation, however WPC disputes the contention that this lack of investment has been caused solely by the introduction of the Gas Access Regime.
135. WPC reiterates that for a number of years now, it has been willing to fund an expansion of the DBNGP to secure developable capacity. Accordingly, lack of availability of funds has not been the problem.
136. The real reason that no expansion of the DBNGP has occurred is that Epic Energy has been in dispute with OffGAR regarding the approval of its proposed access arrangement for the DBNGP. This dispute and the delay it has occasioned are the real reasons that there has been no investment made to expand the DBNGP.
137. The expansion of the pipeline has become linked to the reference tariff setting process for the existing pipeline seemingly as a means of Epic exerting strategic pressure upon both the Regulator and users for higher tariffs. Another consequence of restricting new capacity availability has been higher spot capacity revenue to the pipeline (retained as unregulated revenues) as a windfall reward to the service provider.
138. In circumstances where Epic Energy has refused to accept funding from WPC for an expansion of the DBNGP, the Gas Access Regime cannot be considered the sole culprit for a lack of investment in the expansion of the DBNGP.
139. A number of parties in their submissions to the Productivity Commission review of the Gas Access Regime doubted that the Gas Access Regime had the negative effect suggested by the anecdotal evidence:

criticisms of the Gas Code as chilling investment...by and large...focussed on rhetoric. There has been very little evidence put forward to substantiate those claims and, indeed, we think the evidence is quite the opposite, that there is substantial evidence of increased investment in gas pipelines in Australia since the Code was put in place and we don't think it's merely a coincidence.²⁰

The [Hunter Gas Users Group] considers that there is no substance to the 'investments at risk due to intrusive regulation' assertion about the implementation of the national Gas Access Regime and would argue against any dilution of Code provisions that protect consumer interests and seek a balance on the information and resource asymmetry problems faced by Regulators and gas users.²¹

it is essential that the Commission base its assessment on the objective evidence that exists as to the development of the industry over the period for which the regime would have had an effect, rather than on the industry's unsupported (and, we consider, unsupportable) rhetoric.²²

Invariably, the weaknesses of the current access regime are always cited as the reason for pipeline projects not going ahead, rather than the economic and commercial viability of the projects concerned.²³

140. WPC disputes that there is any conclusive evidence to support the proposition that the Gas Access Regime deters and distorts investment.
141. The Productivity Commission itself conceded that it "faces difficulties in trying to draw conclusions about the effect of the Gas Access Regime on investment based on the information provided by inquiry participants".²⁴
142. It is therefore inappropriate for the Productivity Commission to conclude that the Gas Access Regime deters and distorts investment, and incorrect to base policy recommendations on this conclusion.

D.7 Draft finding 4.4

Information from interested parties supports the view that the Gas Access Regime might have a discouraging effect on innovation and improvements on service offerings.

143. WPC does not agree that it is a necessary outworking of a regime such as the Gas Access Regime that it will have a discouraging effect on innovation and improvements on service offerings.

²⁰ ACCC cited in Productivity Commission 2003, Review of Gas Access Regime, Canberra, p. 100.

²¹ Hunter Gas Users Group Submission to the Productivity Commission's Review of the National Gas Access Regime, (August 2003) (Available: <http://www.pc.gov.au>, accessed 11 March 2004), 8.

²² BHP Billiton Initial Submission to the Productivity Commission, Review of National of (sic) Gas Code, (September 2003) (Available: <http://www.pc.gov.au>, accessed 11 March 2004), 21.

²³ Energy Markets Review Forum, Further Submission to the Productivity Commissions Review of the Gas Access Regime (September 2003), (Available: <http://www.pc.gov.au>, accessed 11 March 2004), 5.

²⁴ Energy Markets Review Forum, Further Submission to the Productivity Commissions Review of the Gas Access Regime (September 2003), (Available: <http://www.pc.gov.au>, accessed 11 March 2004), 5.

144. WPC believes that the factors giving rise to the unique Western Australian circumstances discussed in paragraphs 132 to 138 which may have impacted on investment are also likely to have impacted upon innovation.
145. In addition, it is also highly likely that innovation and improvements in service offerings are affected by the service provider's approach to running its business more than they are affected by the Gas Access Regime.
146. In particular, if a service provider has chosen to rely solely on the reference service or services, rather than being prepared to negotiate non-reference services, that is more likely to be because doing so has been to its advantage – either because of the terms of the reference service, or because refusing to negotiate a non-reference service gives the service provider more negotiating power for future negotiations.

D.8 Draft finding 4.5

Generally, regulation involving access arrangements with a reference tariff should be considered only where service providers have substantial market power. Where market power is not strong, such as where there is emerging competition in the gas industry, the long run costs of regulatory intervention are likely to outweigh the cost of the market failure that regulation attempts to correct.

147. Again, WPC wishes to emphasise that in some circumstances, service providers may have little market power in the eastern States, however in the Western Australian gas transmission sector service providers continue to have a great degree of market power.
148. There is no justification in Western Australia for moving towards a “light-handed” regime that erodes the rights of users, on the grounds that a changed gas transmission sector makes a powerful Gas Access Regime unnecessary. To do so would severely injure the Western Australian market, on the basis of changes that have occurred only in the eastern States.
149. Any amendments to the Gas Access Regime must strengthen, or at least maintain, the rights of users in their dealings with service providers.
150. WPC submits that a third party access regime with access arrangements should be given an opportunity to operate in Western Australia, so that its effects can be judged properly. Only once the initial problems with the implementation of the Gas Access Regime have been overcome and access arrangements have been in operation for a period of time, will the full effects of the regime be able to be judged properly.
151. It is inappropriate to draw conclusions about the operation of the regime based only on the events during the transitional period when the costs of moving to the regime will be most keenly felt and the benefits are yet to fully materialise.

D.9 Draft finding 4.6

There are significant compliance and administration costs in the operation of the Gas Access Regime. Delays in decision making have added to the costs.

152. WPC agrees that there are significant compliance and administration costs in the operation of the Gas Access Regime, however WPC submits that in circumstances where service providers have a great amount of market power, as they do in Western Australia, these costs are necessary to avert the greater costs of inefficient economic outcomes and constraints on upstream and downstream markets.
153. WPC supports any attempt to simplify procedures and reduce compliance and administration burdens on all parties, including service providers, but not at the cost of weakening the Regulator's power to ensure that users are able to obtain gas transmission capacity at an economically efficient cost on terms which are fair to both parties.
154. WPC agrees that a large amount of the costs it and other parties in Western Australia have incurred as a result of the Gas Access Regime have been transitional in nature. In particular, they have related to the determination of the initial capital base for the DBNGP.
155. As noted above, these costs have arisen due to the intersection of the Gas Access Regime with the privatisation of the DBNGP. The determination of the initial capital base has been the primary reason for the delay in the approval of an access arrangement for the DBNGP (see paragraphs 83 and 84).
156. Future access arrangement reviews in Western Australia are unlikely to be as costly for any party as the process of approval of the first access arrangement. This is likely to be the case in other jurisdictions.
157. WPC endorses that view that regulation, once an appropriate access arrangement is in place, has the potential to give rise to significantly reduced transaction costs for each gas transmission contract entered into.
158. WPC reiterates that it is inappropriate to draw conclusions about the operation of the regime based only on events during the transitional period when the costs of moving to the regime will be most keenly felt and the benefits are yet to fully materialise.

D.10 Draft finding 4.7

The current Gas Access Regime has deficiencies. Improvements are possible.

159. WPC agrees that the Gas Access Regime has deficiencies and that improvements are possible.
160. WPC emphasises that there is no justification in Western Australia for moving towards a "light-handed" regime that erodes the rights of users. To do so would severely injure the downstream gas consuming industries in the south-west of Western Australia, and the Western Australian economy generally.
161. The gas transmission market in Western Australia is characterised by a single pipeline connecting the major gas basin located in the north-west of the State, with the majority of industry which is located in the south-west of the State. This means that Epic Energy, as the owner of that pipeline, possesses an inordinate amount of market power.

162. In these circumstances the Gas Access Regime provides necessary protection for users. WPC is fearful of any weakening of third party access regulation in the gas transmission market because it would further undermine the already weak position of users.
163. Further, with the sale of the DBNGP by Epic Energy on the immediate horizon, WPC submits that any significant changes to the regime which weakened users' positions further would destabilise the market. The market conditions in Western Australia have not developed in the same way that they have in the eastern States and accordingly changes to the Gas Access Regime which would adversely impact on the rights of users are not suitable for the Western Australian market.
164. It is likely that some amendments to the Gas Access Regime are needed to improve its effectiveness, but these amendments should not result in service providers being able to exert their market power against users to an even greater degree.
165. The Productivity Commission stated that:
- A regulatory regime that gives regulatory authorities discretion in making a determination might create incentives for the interested parties to engage in lobbying, bargaining and negotiation....Game playing and lobbying increase the costs to users and service providers as they try to influence the Regulator or delay the outcome.²⁵
166. These effects probably do occur, however they should not necessarily be preferred to the economically inefficient exercise of market power that occurs in the absence of regulation of third party access.
167. WPC agrees with Worsley that, in Western Australia, "on balance, the Gas Access Regime delivers a net benefit".²⁶
168. WPC agrees with the Productivity Commission that any unnecessary discretion in the Gas Code should be eliminated.
169. With regard to the determination of the initial capital base, sections 8.10 and 8.11 of the Gas Code should be amended to provide a more prescriptive approach to determining the initial capital base.
170. The purchase price valuation must be excluded to avoid the problem of the very inefficient "regulatory spiral", where, because returns on capital are regulated, it becomes profitable to pay an excessive purchase price so that the regulated rate of return is earned on a larger capital base. As indicated by section 8.11, DAC and DORC should be the primary factors guiding the determination of the initial capital base.
171. However, if the current DAC/DORC bracket is retained, the Gas Code requires amendment to state that the initial capital base must always (rather than just "normally") be determined to be between DAC and DORC. Alternatively, it may be more efficient to move to a simple use of DORC only.

²⁵ Productivity Commission 2003, Review of the Gas Access Regime, Draft Report, Canberra, p. 124.

²⁶ Worsley Alumina submission to: Gas Access Regime inquiry (August 2003), (Available: <http://www.pc.gov.au>, accessed 11 March 2004), 2.

Chapter 5 – Objectives and objects clause

D.11 Draft recommendation 5.1

The following overarching objects clause should be inserted into the Gas Access Regime:

To promote the economically efficient use of, and investment in, the services of transmission pipelines and distribution networks, thereby promoting competition in upstream and downstream markets.

172. WPC agrees that the overarching objects clause set out above should be inserted into the Gas Access Regime, however WPC notes that as presently drafted, there is some ambiguity as to whether the phrase “economically efficient” is intended to qualify “investment in” as well as “use of”.

D.12 Draft recommendation 5.2

With the implementation of draft recommendation 5.1, the following objectives in the preamble to the existing legislation and the related objectives in the introduction to the Gas Code should be deleted:

- (a) facilitates the development and operation of a national market for natural gas*
- (b) prevents abuse of market power*
- (c) promotes a competitive market for natural gas in which customers may choose suppliers, including producers, retailers and traders*
- (d) provides for rights of access to natural gas pipelines on conditions that are fair and reasonable for the owners and operators of gas transmission and distribution pipelines and persons wishing to use the services of those pipelines*
- (e) provides for the resolution of disputes.*

173. WPC agrees that the objectives set out above should be deleted from the preamble to the existing legislation and the introduction to the Gas Code.

D.13 Draft recommendation 5.3

The following elements of s.2.24 of the Gas Code should be deleted:

- (a) the Service Provider’s legitimate business interests and investment in the Covered Pipeline*
- (d) the economically efficient operation of the Covered Pipeline*
- (e) the public interest, including the public interest in having competition in markets (whether or not in Australia)*
- (f) the interests of Users and Prospective Users*
- (g) any other matters that the Relevant Regulator considers are relevant.*

174. WPC agrees that the elements of s 2.24 set out above should be deleted from the Gas Code.
175. WPC notes that it is proposed to retain the element contained in section 2.24(c) of the Gas Code, namely:
- the operational and technical requirements necessary for the safe and reliable operation of the Covered Pipeline
176. Understandably, users are not privy to all of the technical information that is available to a service provider as the operator of a covered pipeline. However this means that an assertion by a service provider that an element of a proposed access arrangement cannot be complied with due to safety reasons cannot be tested or verified by a user.
177. Accordingly, WPC submits that section 2.24(c) should be redrafted to provide that the relevant operational and technical requirements are those that would be required by a reasonable and prudent pipeline operator, or alternatively, a provision equivalent to section 6.21 of the Gas Code should apply in respect of the Regulator’s assessment of a proposed access arrangement under section 2.24.

Chapter 6 – Coverage issues

D.14 Draft finding 6.4

The test ‘would be likely to have the effect of increasing competition in a market to a substantial degree’ would set a higher threshold than ‘promotes competition’.

178. WPC observes that a change in the test in section 1.9(a) of the Gas Code from whether “access...would promote competition in at least one market” to whether “access...would be likely to have the effect of increasing competition to a substantial degree in at least one market” serves to set a higher hurdle to be reached before a pipeline satisfies the coverage criteria.
179. This is clearly to the disadvantage of users such as WPC.
180. WPC rejects the proposal to require that increased access be likely to have the effect of increasing competition to a substantial degree, however, subject to the comments contained in paragraphs 183 to 203 below, WPC would not object to:
- (a) the proposal that the criterion refer to the likelihood of increased access having the effect of increasing competition rather than increased access promoting competition; and
 - (b) the criterion requiring that increased access be likely to have the effect of increasing competition to a material degree.
181. In part, this is because WPC accepts that a formulation in criterion 1.9(a) which refers to the “likelihood of an effect” would be more conventional, in terms of competition and consumer law statutes, and possibly more easily measured and applied than a formulation that refers to “promoting competition”.

D.15 Draft recommendation 6.1

The first criterion for assessing coverage with the current approach to regulation (access arrangements with a reference tariff) (that is, s 1.9(a) of the Gas Code) should be amended such that the National Competition Council would need to be satisfied:

- *that access (or increased access) to Services provided by means of the Pipeline would be likely to have the effect of increasing competition to a substantial degree in at least one market (whether or not in Australia), other than the market for the Services provided by means of the Pipeline.*

182. See comments above in paragraphs 178 and 179.

183. WPC rejects the proposal to change the criterion to require “access ...[to] be likely to have the effect of increasing competition to a substantial degree” (rather than to a material degree) for a pipeline to be subject to regulation with an access arrangement with a reference tariff.

184. WPC considers this amendment to be unacceptable for a number of reasons.

185. First, it diverges too greatly from the related criterion in clause 6(3)(a) of the Competition Principles Agreement (CPA):

For a State ...access regime to conform to the principles set out in this clause, it should ...apply to services where...access to the service is necessary to permit effective competition in a downstream or upstream market...

186. “Effective competition” will not be achieved if coverage is confined to cases where increased access results in a “substantial” increase in competition.

187. The Productivity Commission has stated that “Any changes making the coverage criteria inconsistent with clause 6(3) would thus require changes to the CPA; otherwise, the State and Territory regimes could not be certified as effective”.²⁷ This should not be taken lightly. WPC considers that the fundamental underpinnings and goals of the CPA are important and WPC would be reluctant to support such changes to the CPA.

188. Second, the likelihood of increased access having the effect of increasing competition to a material degree should be considered sufficient justification for applying regulation with an access arrangement with a reference tariff. “Material” has been interpreted to mean something “of moment or significance – not merely trivial or inconsequential”.²⁸

189. Third, in circumstances where the other 3 coverage criteria are satisfied, and a finding is made that increased access is likely to have the effect of increasing competition to a material degree, it seems illogical and extremely difficult to justify how in such circumstances it is sufficient to apply the “monitoring regime”.

190. The “monitoring regime” offers users no protection whatsoever and will not bring about economic efficiency. Its proposed elements are:

²⁷ Productivity Commission 2003, Review of the Gas Access Regime, Draft Report, Canberra, p. 172.

²⁸ Minister for Immigration, Local Government and Ethnic Affairs v Dela Cruz (1192) 34 FCR 348; Regina v Alan John Maslen and Anor, (1995)79 A Crim R 199

a third party access policy formulated by the service provider;

ring fencing and associate contract arrangements that ensure the separation of pipeline operations from associated businesses in upstream and downstream markets;

public disclosure of information by the service provider (which would be well short of the ‘access arrangement information’ currently required under the Gas Code);

scope for a service provider to adopt, at its discretion, additional pro-competitive features, such as a code of conduct; and

a credible threat that the misuse of market power by a service provider would trigger use of the Gas Code’s heavier handed regulation (an access arrangement with reference tariffs).²⁹

191. The monitoring regime is not third party access regulation. It cannot even be described as a toothless tiger. With the exception of the ring-fencing and associate contract requirement, none of the elements impose any constraint on the service provider.
192. The “threat” that “misuse of market power by a service provider would trigger use of the Gas Code’s heavier handed regulation (an access arrangement with reference tariffs)” cannot be described as a credible threat. The arrangement will serve to protect the service provider’s exercise of monopoly power for a five-year period.
193. Users simply cannot afford to wait 5 years, or longer, for a third party access regime to come into operation in relation to a pipeline where the service provider is exercising monopoly power. Users will be forced, because of commercial constraints, to enter into contracts under which they pay monopoly rents, because their only alternative in the medium-term will be “no deal”.
194. At best, the arrangement will influence the service provider to negotiate in good faith in the last 6 months of the five year period, so that if an application to upgrade the coverage is made, the service provider can argue that it is in the midst of promising negotiations and that if its pipeline is covered there is the risk that the entire negotiation process will be undermined.
195. The effect of the monitoring option proposal is that, for a pipeline where:
- (a) coverage is likely to improve economic efficiency significantly (pursuant to draft recommendation 6.4);
 - (b) increased access is likely to have the effect of increasing competition to a material degree;
 - (c) it would be uneconomic for anyone to develop another pipeline to provide the services provided by means of the covered pipeline;

²⁹ Productivity Commission 2003, Review of the Gas Access Regime, Draft Report, Canberra, p. 263.

- (d) access to the services provided by means of the covered pipeline can be provided without undue risk to human health or safety; and
- (e) access to the services provided by means of the covered pipeline would not be contrary to the public interest,

the ineffective, impotent “monitoring regime” would apply.

196. Surely if each of the above criteria are met, rather than entrenching the service provider’s monopoly power, the service provider should be required to provide effective third party access, for example, by means of an approved access arrangement with reference tariffs so that the objects of the Code, promoting the economically efficient use of, and investment in, the services of pipelines, thereby promoting competition in upstream and downstream markets, can be achieved.
197. The Productivity Commission, in Chapter 2, cited the increasing basin-on-basin and pipe-on-pipe competition in the eastern part of Australia, and the increasing interconnectivity of transmission pipelines, as the basis for making draft finding 2.3:

The market conditions facing the gas transmission and distribution sectors have changed significantly since the Gas Access Regime was introduced. In particular, participants in these sectors are increasingly responding to new opportunities that arise in an emerging competitive market. This increased contestability is expected to continue, including through greater connectivity. However, the gas market is still in transition. In this environment, a gas access regime of sorts is still warranted.

198. The increasing level of competition cited by the Productivity Commission is seemingly at odds with their finding that the Gas Access Regime deters and distorts investment. An increased level of basin-on-basin and pipe-on-pipe competition and an increased level of interconnectivity between pipelines obviously will not occur without a significant level of investment.
199. As already noted, this draft finding may have some relevance for the eastern States, however it is of little relevance in an analysis of the Western Australian gas transmission sector.
200. WPC submits that, if indeed increased competition in the eastern States has made “heavy-handed” regulation unnecessary, then, for a given pipeline the tests for coverage, namely:
- (a) coverage is likely to improve economic efficiency significantly;
 - (b) increased access is likely to have the effect of increasing competition to a material degree;
 - (c) it would be uneconomic for anyone to develop another pipeline to provide the services provided by means of the covered pipeline;
 - (d) access to the services provided by means of the covered pipeline can be provided without undue risk to human health or safety; and

- (e) access to the services provided by means of the covered pipeline would not be contrary to the public interest,

are unlikely to be satisfied. Accordingly, there is little risk of a pipeline operator being forced to bear the compliance and administration costs of regulation with an approved access arrangement with reference tariffs if it will not improve economic efficiency significantly.

- 201. As for the proposed monitoring regime, WPC rejects the argument that the monitoring regime provides an environment conducive to negotiation between users and service providers. Proponents of the monitoring regime fail to take into account users' lack of negotiating power and lack of information when negotiating access contracts.
- 202. Users' negotiating power is undermined by the service providers' knowledge that the user is dependent on the supply of gas. This dependence arises from the large sunk costs invested in gas-fired generating plant and the inability, at least in the short term, to utilise alternative fuels in a cost effective manner.
- 203. This applies even in respect of large corporations such as WPC.
- 204. Accordingly, it would be incorrect to assume that users are able to utilise negotiating power to achieve balanced, economically efficient access tariffs in the absence of regulation involving an approved access arrangement with reference tariffs.
- 205. Finally, WPC is concerned that the proposed test risks introducing a high level of discretion and uncertainty into coverage decisions, by creating a triangular combination of three quantifiers of effects described in the tests:
 - (a) significant improvement of economic efficiency;
 - (b) increase in competition to a material degree; and
 - (c) increase in competition to a substantial degree.
- 206. Related to this concern is the risk that by introducing additional discretion, further potential for dispute will be introduced into the regime. This will complicate the process and increase its cost, which will have the effect of delaying the achievement of the objects of the Gas Access Regime.
- 207. The test in criterion 1.9(a) should refer simply to a likely effect of a material increase in competition.

D.16 Draft recommendation 6.2

The Gas Access Regime should be amended to give guidance on matters to consider in assessing the 'promotion of competition' test in coverage decisions.

- 208. WPC acknowledges that providing guidance in the form of factors to be considered in assessing the "promotion of competition" test might "reduce business uncertainty" and "provide assurance that the appropriate factors are identified and that consistent criteria are being used".³⁰

³⁰ Productivity Commission 2003, Review of the Gas Access Regime, Draft Report, Canberra, p. 179.

209. However, WPC does not believe that such guidance is necessary in circumstances where coverage decisions have generally been satisfactory. No case has been made that, at present, coverage decisions are inconsistent or made without a rational basis.
210. It is likely that coverage decisions are being based upon criteria largely resembling those proposed by the Productivity Commission as a possible list of matters to be taken into account.
211. WPC submits that, should any such guiding factors be adopted, the factors included, and factors not included, as well as the precise wording of the factors, would need to be subject to close scrutiny to ensure that they do not produce unintended consequences.
212. WPC has not reviewed the proposed factors in detail as this task is outside the scope of this submission.

D.17 Draft recommendation 6.4

The coverage criteria in s 1.9 of the Gas Code should include a new test – namely, that coverage of the pipeline is likely to improve economic efficiency significantly.

213. WPC notes that draft recommendation 6.4 serves to set a higher hurdle to be reached before a pipeline satisfies the coverage criteria than presently exists. This is clearly to the disadvantage of users such as WPC.
214. However, WPC would not object to the inclusion of a proposed new criterion if there was no monitoring option, and section 1.9(a) of the Code was amended from its present form, which reads:

”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”

to read as follows:

”that access (or increased access) to Services provided by means of the Pipeline would be likely to have the effect of increasing competition to a material degree in at least one market (whether or not in Australia), other than the market for the Services provided by means of the Pipeline.”

215. There is little justification for including a requirement that, for a pipeline to be covered with an access arrangement with reference tariffs, there be a likelihood that economic efficiency will be improved significantly, and also that there be a likelihood that it will increase competition to a substantial degree in at least one market. The proposed criteria are likely to overly complicate the existing tests.
216. A material increase is the appropriate threshold.

D.18 Draft recommendation 6.5

Section 1.9(a) of the Gas Code (the first of the coverage criteria) should be amended such that access (or increased access) to Services provided by means of the Pipeline would be likely to have the effect of increasing competition to a material degree in at least one market

(whether or not in Australia), other than the market for the Services provided by means of the Pipeline.

217. See paragraphs 178 to 216 above.

D.19 Draft recommendation 6.6

The Gas Access Regime should be modified such that the National Competition Council, in making a recommendation that a pipeline should be covered, should also recommend the form of regulation to apply to the pipeline.

The monitoring regime should be applied if one of the following applies:

- if access (or increased access) would be likely to have the effect of increasing competition to a material, but not a substantial, degree (and if the other tests are met)

- if access (or increased access) would be likely to have the effect of increasing competition to a substantial degree, but applying the monitoring regime (with its lower costs) would improve economic efficiency more than would an access arrangement with reference tariffs (and if the other tests are met).

The current regulatory approach (access arrangements with reference tariffs) should be applied if access (or increased access) would be likely to have the effect of increasing competition to a substantial degree, and if such regulation would improve economic efficiency more than would the monitoring regime (and if the other tests are met).

218. See paragraphs 178 to 216 above.

219. WPC finds it difficult to see any positive effects that could be achieved by implementing the monitoring option.

220. The monitoring option is certainly not suitable for Western Australia's major gas transmission pipelines.

221. As stated above, there has been no significant change in the market conditions facing the gas transmission sector in Western Australia since the introduction of the Gas Access Regime. There remains little or no interconnectivity between gas fields and markets, and transmission pipelines, in Western Australia, and no significant pipe-on-pipe competition (see paragraphs 42 to 68).

222. Accordingly, any amendments to the Gas Access Regime must be to strengthen, or at least maintain, the current rights of users in their dealings with service providers.

223. There is no justification in Western Australia for moving towards a "light-handed" regime which erodes the rights of users. WPC does not believe that changes in the gas transmission sector in some regions in Australia makes a powerful Gas Access Regime unnecessary or that the costs of compliance with and administration of the Gas Access Regime justify a "light-handed" regime.

224. Of great concern to WPC is fact that the monitoring option does not appear to provide for dispute resolution. If this is the case, an aggrieved user will have no way of pursuing access in the face of a refusal to grant access by the service provider. This would be a serious roll-back of users' rights compared with:

- (a) the various state-based access regimes that applied to gas pipelines before the Gas Access Regime; and
- (b) access rights under Part IIIA of the *Trade Practices Act 1974* (Cth) where no industry-specific regime is in place.

225. WPC's view is that this would be a retrograde step. In essence it would involve dismantling third party access for each gas pipeline that is subject to the monitoring regime. WPC queries the policy and motivations behind such a move. Please see paragraphs 253 to 262.

D.20 Draft recommendation 6.7

Where the monitoring option is applied, it should apply for a minimum period, say five years. During this period, no one would be able to apply for coverage with price regulation (an access arrangement with reference tariffs).

226. WPC does not believe that specifying a minimum period during which time no one is able to apply for coverage with price regulation is likely to force users and service providers to negotiate in good faith.
227. The five year period is sufficiently long that a service provider will be able to exercise its market power to ensure advantageous, economically inefficient outcomes, with the knowledge that it is protected from reference tariff regulation for a minimum period of 5 years.
228. The problems associated with the service provider exercising its market power to its advantage are potentially intensified because recourse to price regulation is denied for such a long period of time. This may exacerbate uncertainty, rather than curb it, and risks deterring upstream and downstream investment.
229. WPC rejects the suggestion that only the relevant Regulator should be able to apply for a pipeline regulated under the monitoring regime to be changed to regulation under the access arrangement regime.
230. While the Regulator may be in a good position to make an application, the user is also in a good position, and a user's ability to seek to protect its business interests should not be needlessly restricted in this way. Any user should be able to make such an application, and the Minister, after applying the coverage criteria should be the judge of the merits of the application.
231. It is unwise and inconsistent with past practice to give the Regulator a major role in coverage decisions. The Productivity Commission has made no case for why users should be precluded from making an application, simply stating the following with no detail or supporting evidence:

If users of a pipeline covered by the monitoring regime could apply, then costly strategic behaviour could result.³¹

232. Further, the proposal to give the Regulator a role in coverage decisions (the role of veto) conflicts with the Productivity Commission's draft recommendation 12.1, which

³¹ Productivity Commission 2003, Review of the Gas Access Regime, Draft Report, Canberra, p. 196.

states that the agency responsible for making recommendations on pipeline coverage decisions should be separate from the Regulator responsible for administering the terms of pipeline access.

D.21 Draft recommendation 6.8

The Gas Access Regime should be amended to provide that where a service provider potentially covered by the Gas Code lodges a part IIIA undertaking, this should trigger an assessment (currently by the National Competition Council) to determine whether the pipeline meets the requirements for coverage under the Gas Code. The Australian Competition and Consumer Commission's assessment of the part IIIA undertaking should be held over, pending the outcome of the coverage assessment.

233. WPC supports draft recommendation 6.8.

Chapter 7 – Access Arrangements

D.22 Draft recommendation 7.1

Section 8.1 of the Gas Code should be replaced with the following:

The relevant Regulator must have regard to the following principles when approving a reference tariff or reference tariff policy:

(a) that reference tariffs should:

- (i) be set so as to generate expected revenue across a service provider's regulated services that is at least sufficient to meet the efficient long-run costs of providing access to those services*
- (ii) include a return on investment commensurate with the regulatory and commercial risks involved*
- (iii) generate revenue from each service that at least covers the directly attributable or incremental costs of providing the service.*

(b) that reference tariff structures should:

- (i) allow multi-part pricing and price discrimination when it aids efficiency*
- (ii) not allow a vertically integrated service provider to set terms and conditions that disadvantage competitors of its associated businesses in upstream or downstream markets, except to the extent that the cost of providing access to these competitors is higher.*

(c) that reference tariffs should be set so as to provide incentives to reduce costs or otherwise improve productivity.

234. Generally, WPC supports the pricing principles contained in draft recommendation 7.1, however see the comments at paragraphs 240 to 242 below.

235. WPC does not agree that “the Gas Access Regime’s building block approach has inhibited commercial negotiations” or that “the regime tends to operate as a form of

- price cap regulation in which the services provided and prices charged to third party access seekers are largely restricted to those approved by regulators”³².
236. There is no justification for the argument that the Gas Access Regime necessarily inhibits commercial negotiations. In fact, by addressing the information and bargaining power asymmetry that exists between service providers and users, it should facilitate commercial negotiations.
237. In addition, it is not justified to argue that the regime necessarily should operate as a form of price cap regulation with services and prices restricted to those approved by regulators.
238. Users tend to have different needs, and service providers should be negotiating to offer customised services to the users with the associated non-reference prices. Service providers are expressly required to do so under sections 3.2(b) and 3.2(c) of the Gas Code. If they fail to do so this reflects a use of market power by the service provider, rather than any causal effect of the Code.
239. If a service provider will not negotiate with a user to provide a non-reference service in circumstances where:
- (a) the access arrangement for the pipeline contains approved reference services and tariffs; and
 - (b) express obligations under sections 3.2(b) and 3.2(c) apply to the service provider requiring it to negotiate to provide non-reference services,
- then there is little chance of the service provider negotiating to provide a non-reference service to a user if those constraints and obligations are removed, for example if the “monitoring option” applies or there is no third party access.
240. As to proposed pricing principle 8.1(a)(i), WPC submits that the phrase “at least” should be deleted so that the principle reads:
- reference tariffs...should...be set so as to generate expected revenue across a service provider’s regulated services that is sufficient to meet the efficient long-run costs of providing access to those services...
241. WPC believes that proposed pricing principle 8.1(a)(i) should be a target, not a floor or a ceiling. The service provider can obtain additional revenue to the extent that sales are greater than forecast or costs are less than forecast. This is already contemplated by proposed pricing principle 8.1(c). WPC is concerned that the use of “at least” sets a lower bound, but no upper bound, which has disturbing implications for regulated tariff levels.
242. As to proposed pricing principle 8.1(a)(ii), WPC submits that “regulatory and commercial” should be deleted so that the proposed pricing principle simply refers to the return being commensurate with the risks involved. This is because there are many types of risks for any operator (eg Regulatory, commercial, market, currency) and there is no reason that commercial and regulatory should be singled out.

³² Productivity Commission 2003, Review of the Gas Access Regime, Draft Report, Canberra, p. 202.

D.23 Draft recommendation 7.3

The Gas Code should be amended to ensure that Regulators' requirements for establishing and maintaining information are standardised across jurisdictions and are as close to existing gas industry accounting or record keeping practices as possible.

243. WPC supports draft recommendation 7.3.
244. WPC submits that, with respect to the Regulator's powers to obtain information and documents under section 41 of Schedule 1 to the Gas Pipelines Access Law ("**GPA Law**"), the restriction on disclosure under sections 42 and 43 of the GPA Law should be consistent with the restriction on disclosure under section 7.12 of the Gas Code. There appears to be some unnecessary duplication.
245. See also WPC's comments below at paragraphs 302 to 309 with respect to sections 5.1 to 5.3 and 5.9 of the Gas Code.
246. WPC believes that it is essential that Regulators have the ability to obtain sufficient information from service providers to adequately assess their proposed access arrangements. Enabling the Regulator to verify a service provider's assertions goes some way to addressing the information asymmetry between users and service providers.
247. WPC agrees with the Productivity Commission's statement that:

If the building block approach is seen as necessary, then there seems to be limited scope to reduce the information requirements for service providers, given that Regulators need a significant level of information to fulfil their obligations.³³

D.24 Draft finding 7.4

Service providers could facilitate capacity trading by posting information on their websites regarding unutilised capacity that shippers want to trade.

248. WPC agrees with this draft finding however submits that the Trading Policy required under sections 3.9 to 3.11 of the Code should be expanded to require service providers to include a capacity trading regime in its access arrangement.
249. For example, Epic Energy in its proposed access arrangement for the DBNGP included the "Secondary Market" for capacity trading. WPC supports this initiative however believes that short-term capacity trading should be regulated by the Gas Code. Leaving it unregulated gives the service provider very substantial market power in this important and potentially lucrative segment of the market.

³³ Productivity Commission 2003, Review of the Gas Access Regime, Draft Report, Canberra, p. 245.

D.25 Draft recommendation 7.4

Section 3.16 of the Gas Code should be amended so that any expansion of a covered pipeline will be treated as part of the covered pipeline, unless the service provider nominates otherwise and the Regulator agrees.

250. WPC supports draft recommendation 7.4. However WPC would prefer to see it strengthened to provide that any expansion of a covered pipeline will always be treated as part of the covered pipeline, with no ability for the service provider to nominate otherwise, on the grounds that if a pipeline is covered because it is judged to have market power, then it is likely that this market power would exist in relation to any capacity created as a result of an expansion.

D.26 Draft finding 7.6

The current regulatory approach of having access arrangements with reference tariffs is costly, especially in relation to the market impact. Therefore, while some refinements to the existing regulatory approach are needed, there is a sound basis for an alternative less costly approach.

251. WPC disagrees with draft finding 7.6. Western Power agrees that some refinements to the existing regulatory approach are needed, but does not agree that there is a sound basis for an alternative, less costly approach (see paragraphs 182 to 231 above).

Chapter 8 – Lighter-handed regulation

D.27 Draft recommendation 8.1

The Gas Access Regime should be amended to provide for a lighter handed form of regulation whereby the application of the alternative regulation involving an access arrangement with reference tariffs would only occur in the more extreme circumstances. The lighter handed alternative should be a monitoring regime. It is important that the monitoring regime not develop into an intrusive and costly form of regulation.

252. WPC disagrees with draft recommendation 8.1 (see paragraphs 182 to 231 above).

D.28 Draft recommendation 8.2

The monitoring form of regulation to be implemented under the Gas Access Regime should have the following features:

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

253. WPC disagrees with draft recommendation 8.2 (see paragraphs 182 to 231 above).

254. If the Productivity Commission recommends the implementation of the monitoring option in its Final Report, WPC submits that the recommendation must be developed further.
255. The first limb, the requirement that there be a third party access policy formulated by the service provider, must require the service provider to specify in the third party access policy at least one service (and preferably a number of services), the terms and conditions on which the service will be provided and the tariff applicable to the service. The service provider would be required to make that service available to a prospective user seeking the service, subject to there being spare capacity available.
256. This is different from a reference service under access arrangement regulation because the service provider would not be required to show that it has gone through the 'building block method' to arrive at the tariff, it would simply formulate the service terms and conditions and tariff the way an unregulated business which wishes to publish a price list does.
257. The service provider will however have incentive to set the tariff at a reasonable level, because a failure to do so could count against it if, in the future, an application is made to "upgrade" the pipeline's coverage to regulation with an access arrangement with reference tariffs.
258. Also, WPC seeks clarification on whether the monitoring option, as proposed, will enable a user to initiate an access dispute with a service provider if access contract negotiations are proving unsuccessful.
259. It is not clear if arbitration under section 6 of the Gas Code would be available or, if not, whether a user would be able to bring a court action. WPC would be very concerned with the monitoring option if there is no ability to seek binding dispute resolution, because, as stated, users simply cannot afford to wait 5 years, or longer, for the opportunity to commence an access dispute in relation to a pipeline where the service provider is exercising monopoly power. Users will be forced, because of commercial constraints, to enter into contracts under which they pay monopoly rents, because their only alternative in the medium-term will be "no deal".
260. Mandatory, binding dispute resolution under the monitoring regime is necessary, because at best, the monitoring regime will influence a service provider to negotiate in good faith in the last 6 months of the five year period, so that if an application to upgrade the coverage is made, the service provider can argue that it is in the midst of promising negotiations and that if its pipeline is covered there is the risk that the entire negotiation process will be undermined.
261. The Commission suggests that the possibility of upgrading the regulatory approach that applies to a covered pipeline will operate as an effective threat against service providers exploiting their market power whilst operating under the monitoring regime. With respect to this view, WPC considers that a 5-year period during which time no upgrade of coverage can be sought will seriously undermine the credibility of such a threat. However, it should not be forgotten that the immediate threat of binding dispute resolution has not enabled WPC to get access to the DBNGP yet. The solution to this exercise of market power by a service provider is not to soften the regime.

262. If the monitoring option does not include a mandatory, binding, dispute resolution process, users will have substantially worse access rights than they would have if there was no industry-specific access regime and the only access route was declaration under Part IIIA of the *Trade Practices Act 1974* (Cth).

D.29 Draft recommendation 8.3

In making a coverage decision to apply the monitoring regime, the National Competition Council should specify what information the service provider is required to disclose to the relevant Regulator. Implementation of the information disclosure requirements would involve:

- *the Regulator focusing more on trend performance, including in relation to profitability*
- *reporting and monitoring after the event, without any need for prior endorsement by the Regulator*
- *the Regulator particularly monitoring cases where access negotiations have been unsuccessful.*

263. WPC does not consider the monitoring regime to be an adequate alternative. Strong information provisions will be needed even if not quite access arrangement information levels.

D.30 Draft recommendation 8.4

The relevant Regulator should collate and publish annually the information disclosed by a pipeline under the monitoring regime. Any commentary made by the Regulator should be of a factual nature only.

264. WPC does not consider the monitoring regime to be an adequate alternative to the current regime. The collation and publication of information as contemplated under the proposed monitoring regime may not be adequate to achieve the proposed objects of the Code (see paragraphs 182 to 231 above).

Chapter 9 – Investment and access arrangements

D.31 Draft recommendation 9.1

The Gas Access Regime should be amended so that the National Competition Council, on request from a potential pipeline investor, can provide a binding ruling on coverage. A binding ruling in favour of lighter handed monitoring should be for the same duration as the minimum period for lighter handed monitoring under the regular coverage test (five years). A binding ruling that a pipeline would not be covered should apply for 15 years. These rulings should not be revoked unless the information relied on by the National Competition Council is proven to be false or intentionally misleading.

265. WPC does not object, in principle, to the notion of the National Competition Council having the power to provide a binding ruling on coverage on application from a service provider.

266. However, WPC submits that any such ruling should be made after consultation in accordance with the usual consultation procedure for coverage under section 2 of the Gas Code.
267. Further, in no circumstances should any such ruling be for a period longer than five years.
268. As set out above, WPC rejects the proposal that there to be two forms of regulation under the Gas Code: regulation with an access arrangement with reference tariffs and the “monitoring option”.
269. However, should the proposal to include the monitoring option be successful despite its disadvantages, WPC submits that it would be unacceptable to permit a 15 year binding ruling for a decision that a pipeline not be covered.
270. This is because, if the coverage criteria are set as they should be, pipelines will only be covered where the service provider is in a position to exert market power that inhibits upstream and downstream competition.
271. Where a service provider *is* in a position to exert market power that inhibits upstream and downstream competition, it is essential that the pipeline be covered in order to achieve economic efficiency.
272. Further, WPC disputes that there is any evidence to support the proposition that the Gas Access Regime deters and distorts investment (see paragraphs 132 to 142).
273. In the absence of any negative effects on investment, there is no need for binding rulings providing a 15 year access holiday.
274. The Productivity Commission itself conceded that it “faces difficulties in trying to draw conclusions about the effect of the Gas Access Regime on investment based on the information provided by inquiry participants”.³⁴
275. WPC cautions the Productivity Commission against proceeding with a proposal that will provide the owners of monopoly assets with free reign to exert monopoly power as a response to nothing more than an unsubstantiated claim that the Gas Access Regime has had a “chilling effect” on investment.
276. WPC does not dispute the possibility that the Gas Access Regime may result in regulatory risk (coverage and parameter risk) or the asymmetric truncation of returns, however WPC submits that these risks are part of the operating environment for pipeline operators and are dealt with adequately by the Gas Access Regime at present.

Chapter 10 – Ring fencing and associate contracts

D.32 Draft finding 10.1

The ring fencing and associate contract provisions of the Gas Code are warranted and are important for an effective regulatory regime. They do not appear to have involved inappropriate costs.

³⁴ Productivity Commission 2003, Review of the Gas Access Regime, Draft Report, Canberra, p. 108.

277. WPC supports draft finding 10.1.

D.33 Draft recommendation 10.1

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

278. WPC submits that if the Gas Code is amended in accordance with draft recommendation 10.1, further amendments are required to:

- (a) oblige the service provider to notify the Regulator of the details of the terms of the associate contract as well as of the fact that it has been entered into; and
- (b) give the Regulator the power to either disallow or vary the associate contract if the Regulator forms the view that the associate contract “would have the effect, or would be likely to have the effect, of substantially lessening, preventing or hindering competition in a market”.³⁵

Chapter 11 – Administrative and appeal processes

D.34 Draft finding 11.1

There are valid concerns about the inadequate timeliness of regulatory decisions in some cases under the Gas Access Regime.

279. WPC supports this finding. As set out in paragraphs 83 and 84 above, Epic Energy was required to submit a proposed access arrangement for the DBNGP to the Regulator by 9 November 1999.

280. An access arrangement was only recently approved, taking effect from 13 January 2004. However the approved access arrangement is being challenged before the Gas Review Board (the “relevant appeals body” in Western Australia under the Gas Code) by three parties, so it could be some time before a final initial access arrangement is in place for the DBNGP.

281. Under section 2.21 of the Gas Code, the Regulator must issue a final decision within 6 months of receiving a proposed access arrangement.

282. Accordingly, the approval of an access arrangement in January 2004 was 3 years and 8 months “overdue”. And even in February 2004, the access arrangement is being challenged and may in the future be set aside or varied.

283. However, as can be seen from paragraphs 83 and 84, the delay is not attributable solely to the Regulator. Some delay resulted from Epic Energy being required to submit revised Access Arrangement documentation on the grounds that the Access Arrangement documentation originally submitted did not comply with the Gas Code. Over a year of delay was caused by Epic Energy’s Supreme Court challenge of the draft decision.

³⁵ Gas Code, section 7.1.

284. In addition, as argued, the initial problems with the implementation of the Gas Access Regime in Western Australia have been transitional in nature.
285. In the case of the DBNGP, the problems have arisen primarily from the intersection of the Gas Access Regime with the privatisation of the DBNGP.
286. For the Goldfields Gas Pipeline, the problems have arisen primarily from the intersection of the Gas Access Regime with the *Goldfields Gas Pipeline Agreement Act 1994* (WA).
287. WPC reiterates, however, the transitional nature of these problems, and submits that a third party access regime with access arrangements should be given an opportunity to operate in Western Australia, so that its effects can be properly judged.
288. Only once the initial problems with the implementation of the Gas Access Regime have been overcome and an access arrangement for the DBNGP has been in operation for a period of time, will the full effects of the regime be able to be judged properly.

D.35 Draft recommendation 11.1

The Gas Access Regime should be amended, whereby the Regulator would:

- *be able to extend the period for approval of an access arrangement by two months only once*
 - *have the discretionary power to backdate reference tariffs.*
289. WPC supports the first part of draft recommendation 11.1 (permitting the Regulator to extend the period for approval of an access arrangement by two months only once) however notes that the effectiveness of such a limitation may be affected by:
- (a) the inherent complexity involved in the approval of an access arrangement;
 - (b) judicial review proceedings brought during the approval process; and
 - (c) inadequate information provision to the Regulator by the service provider.
290. With respect to the second part of draft recommendation 11.1 (giving the Regulator discretionary power to backdate tariffs), WPC notes that this option is not without its own difficulties, as noted by the Productivity Commission.³⁶
291. At first impression, reserving the power to be exercised at the Regulator's discretion has some appeal, because the Regulator would be able to exercise the power only in those cases where backdating is considered appropriate.
292. However this then becomes another potential source of conflict and litigation, with an aggrieved party able to challenge the Regulator's decision to exercise or not exercise the power, and the manner of the exercise of the power, for example, in respect of what date the backdating should commence, what is a comparable service under the approved access arrangement to the service that the user has been receiving, and therefore what is the appropriate price etc.

³⁶ Productivity Commission 2003, Review of the Gas Access Regime, Draft Report, Canberra, pp 344-45.

293. A number of these issues already exist in Western Australia in respect of the transition from the first statutory access regime to the second statutory access regime and in respect of the transition from the second statutory access regime to the Gas Access Regime, and in some cases the parties are in dispute as to the application of the relevant provisions.

E Western Power's submissions on matters not addressed in draft report

E.1 Obligation on service provider to expand pipeline

294. The capacity constraints of the DBNGP and Epic Energy's failure to expand the DBNGP have had a serious negative effect on WPC. WPC requires extra gas transmission capacity for its current and future electricity-generation needs as a matter of urgency.
295. Until there was an approved access arrangement under the Gas Code in effect for the DBNGP (13 January 2004), the DBNGP remained subject to a DBNGP-specific statutory third party access regime.
296. In WPC's view, under that regime Epic Energy has been subject to a statutory obligation to expand the DBNGP for a number of years, however Epic Energy has failed to do so.
297. In seeking to enforce Epic Energy's compliance with its obligations WPC has had to contend, throughout the interim period from 1 January 2000 to 13 January 2004, with the very complicated intersection of the DBNGP-specific statutory third party access regime and the Gas Access Regime.
298. WPC has been forced to bring proceedings under the DBNGP-specific statutory third party access regime before the Western Australia Gas Referee because before 13 January 2004 the Gas Referee had exclusive jurisdiction and the Gas Code access dispute provisions were not available to WPC.
299. Epic Energy has obfuscated and avoided complying with its statutory obligation to expand the DBNGP. All of this has meant that WPC has faced procedural difficulties in taking action to force Epic Energy to comply with its statutory obligations to expand the DBNGP, which has been to WPC's disadvantage, and to the disadvantage of the State of Western Australia generally.
300. WPC hopes that once an approved access arrangement is finalised, and it is able (if necessary) to commence an access dispute under the Gas Code, it will be able to secure expansion to meet its needs.
301. WPC wishes to emphasise that arbitrated expansion is arguably the most critical aspect of the Gas Code. Historically in Western Australia arbitrated expansion has been difficult to secure. Users' rights in respect of arbitrated expansion under the Gas Access Regime must be at least maintained and preferably must be strengthened.

E.2 Obligation on service provider to maintain information package and public register of capacity

302. Sections 5.1 to 5.3 of the Gas Code requires a service provider to establish and maintain an Information Package containing certain information and to provide the Information Package to a user upon request. Section 5.9 requires a service provider to maintain a Public Register on capacity.
303. In addition, sections 5.4 to 5.7 of the Gas Code set out a framework governing a service provider's response to specific requests for information from prospective users.
304. Robust information-provision obligations on service providers are needed under the Gas Code to address the information asymmetry between service providers and users and thereby improve users' weak bargaining positions.
305. As with arbitrated expansion (discussed in paragraphs 294 to 301 above), WPC's experience with obtaining information from service providers has predominantly been under the DBNGP-specific statutory third party access regime that applied to the DBNGP until 13 January 2004, rather than under the Gas Access Regime.
306. However, WPC suspects that many of the difficulties that it has faced under the previous regime will continue to exist under the Gas Access Regime.
307. The primary problems arise are:
- (a) where the service provider fails to provide the information it is obliged to provide at all; and
 - (b) where the service provider provides some information, purportedly in satisfaction of its obligations, but the information is inadequate.
308. For example, since May 2000 WPC has been in regular communication with representatives of Epic Energy with a view to obtaining further capacity in the DBNGP for WPC and with a view to obtaining information as to available capacity in the DBNGP both at present and in the future.
309. Epic Energy was required by law (under the DBPRs) to produce and make available annual reports and forecast, looking forward over a five year period, detailing available capacity along the lines of the Public Register under section 5.9 of the Gas Code.
310. WPC repeatedly requested a copy of the reports and forecasts, to no avail, culminating in WPC making a formal written request to Epic Energy on 20 November 2002. WPC made a number of further written requests for the reports and forecasts.
311. Epic Energy finally provided copies of the reports and forecasts to WPC on 14 June 2003, under threat of litigation.
312. The result was that WPC suffered a long delay before it received the information (which was 13 months after the first informal request and 7 months after the first written request), which seriously prejudiced WPC's business planning and negotiations with Epic Energy.

313. Further, WPC was forced to incur legal costs in obtaining the information.
314. This is simply unacceptable.
315. WPC submits that the enforcement of these obligations, given that they are so important to the functioning of the Gas Access Regime, should rest with the Regulator, upon receipt of a complaint from a user.
316. The Regulator is the person who is in the best position to judge whether the information provided by the service provider meets the requirements under the Gas Code.
317. Leaving the enforcement of the information provision obligations to users effectively creates a loophole whereby service providers can continue to exert monopoly power. The burden on the user in these circumstances is simply too great and many users are unlikely to have the resources to pursue a dispute of this nature as well as the ultimate access dispute.
318. Also, WPC submits that amendments are required to section 5.6 of the Access Code. At present, it provides:

If the Service Provider advises that Capacity does not exist to satisfy the request, it must provide an explanation outlining those aspects of the request which cannot be satisfied and indicating, based on current commitments, when the requirement might be able to be satisfied.

319. If a service provider advises that capacity does not exist to satisfy a request, a user should be able to request, and the service provider should be obliged to provide, preliminary information in reasonable detail regarding the nature of the expansion that would be necessary to accommodate the request, the timing for such an expansion and the approximate cost.
320. The user must then, if the user so desires, be able to obtain detailed information regarding the nature of the expansion that would be necessary to accommodate the request, the timing for such an expansion and the cost of the expansion, including engineers reports and itemised costings, upon the payment of a reasonable fee by the user.
321. The service provider should be obliged to comply with strict timelines.

E.3 Requirements for Services Policy under Gas Code

322. Sections 3.1 to 3.6 of the Gas Code, dealing with the Reference Tariff Policy and the Services Policy, are deficient in some respects.
323. An access arrangement must set out at least one reference service, the reference tariff for that service and the terms and conditions for the supply of that service.
324. Other services in the Service Policy need only be described. Experience has shown that Regulators have been content with the service provider simply naming the services, for example:
 - (a) Park and Loan Service;

- (b) Peaking Service;
 - (c) Metering Information Service;
 - (d) Secondary Market Service; and
 - (e) Pressure and Temperature Control Service.
325. Without specified terms and conditions and price, or at least some sort of detailed description of what the service might entail, the inclusion of these “services” in the Services Policy is of no value to a user. WPC recognises that there is no need to set a reference tariff for a non-reference service, but a more detailed description of the nature of the service and terms and conditions other than price is required.
326. This point intersects with section 3.3, which provides that:
- An Access Arrangement must include a Reference Tariff for:*
- (a) *at least one Service that is likely to be sought by a significant part of the market; and*
 - (b) *each Service that is likely to be sought by a significant part of the market and for which the Relevant Regulator considers a Reference Tariff should be included.*
327. This test has been interpreted by Regulators as requiring the inclusion in an access arrangement of only the reference service (or services) proposed by the service provider.
328. Also, Regulators have appeared to apply the test ex post, asking “If this service is included, will a significant part of the market seek it?” Of course, where no other services are offered, users in the market will have no choice but to seek the service. This is a second-best outcome and is economically inefficient.
329. It is doubtful that this is the intent of the provision. The provision should be amended to require that an access arrangement include a reference tariff for each service that is likely to be desired (as opposed to sought) by a significant part of the market, unless a good reason can be shown that the service should not be a reference service. Further, the Regulator should not take a “bare minimum” approach where this is not economically efficient.
330. If more services are designated as reference services, this will go some way to overcoming the problem described in paragraphs 323 and 324 with respect to the lack of information provided in the Services Policy with respect to services, which are not reference services.
331. The provision should also be amended to include a presumption that any service that has been a reference service during a previous access arrangement period or a service offered under a different third party access regime will satisfy the test and should be included as a reference service, unless a good reason can be shown otherwise.

332. This will aid the objects of the Gas Access Regime by facilitating the transition between regimes and access arrangement periods, for both users and service providers, thereby increasing economic efficiency.

E.4 Drafting of the Gas Code

333. In general, the drafting of the Gas Code tends to be unclear and is often difficult to interpret. The Gas Code would benefit from being redrafted in “plain English”.

E.5 Awarding the costs in access arbitrations

334. WPC believes that service providers sometimes exercise their market power by refusing to engage in good faith in commercial negotiations for non-reference services.
335. If a service provider does so, a user is able to pursue its rights through arbitration, however it would be helpful to build additional incentive into the regime for the service provider to negotiate in good faith for non-reference services.
336. This may be done by amending section 30 of Schedule 1 in the Gas Access Regime to provide that the conduct of both the user and the service provider in the access contract negotiations which are the subject of the dispute must be considered by the arbitrator when making an order for costs.
337. This would be achieved by requiring the arbitrator to make a finding as to each party’s conduct in the access contract negotiations and applying a presumption that where one party is found to have not negotiated in good faith in the access contract negotiations, that party must bear both parties’ costs of the arbitration.

E.6 Collateral benefits of the Gas Access Regime

338. WPC wishes to draw the Productivity Commission’s attention to a collateral benefit of the Gas Access Regime that WPC has observed.
339. The simple fact that parties now have easy access to the standard terms and conditions for reference services for each covered pipeline in Australia, through the publication of approved access arrangements, has created an invaluable resource for parties engaged in gas transmission or distribution contract negotiations.
340. The terms and conditions contained in approved access arrangements can serve to set industry standard benchmarks which, because they have been examined by the Regulator in the approval process against objective criteria, can go some way to addressing the information asymmetry between users and service providers.