



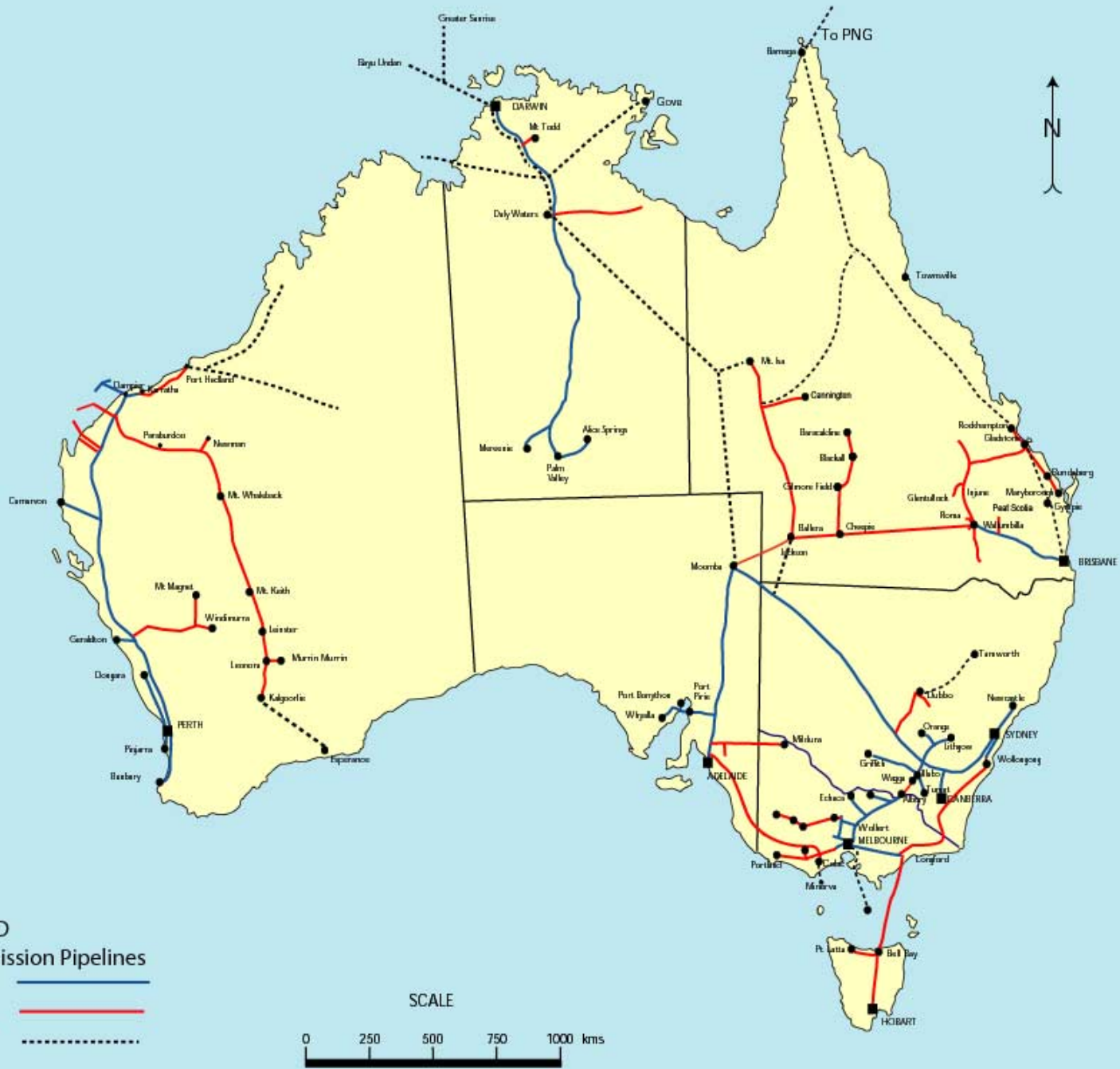
Improving the Gas Access Regime and the National Gas Code

Australian Energy & Utility Summit

J K McDonald

Australian Pipeline Trust (APA)

10 July 2003



Pipelines privatised during 1990s

Pipeline Name & State	Year sold	Regulatory status
MSP, C'wealth	1994	Covered – revocation application
PASA, SA	1995	Covered – under appeal
SGP, Qld	1997	Covered – tariff derogated
DBNGP, WA	1998	Covered – Supreme Court action, draft decision reissued, decision to be appealed
GasNet, Vic	1998	Covered – under appeal



Major pipelines constructed during '90s

Pipeline Name & State	Built	Regulatory status	Basis of decision to construct
ICP, NSW-VIC	1998	Covered – rolled into EAPL and GasNet	Marginal economics market connector
EGP, NSW-VIC	2000	Not covered – revoked on appeal	Negotiated contracts
CWP, NSW	1998	Covered	Greenfields Gas Market
MWP, WA	1999	Not covered	Contract with PMA Mine
GGP, WA	1996	Covered – tariffs from state agreement	State agreement



Major pipelines constructed during '90s

Pipeline Name & State	Built	Regulatory status	Basis of decision to construct
CGP, Qld	1998	Covered – tariff derogated	Agreement with Government.
SWQP, QLD	1998	Covered – tariff derogated	Agreement with Government.
RBP LOOP, QLD	2003	Covered – tariff derogated	Agreement with Government.
Tasmania	2002	Not covered	
Seagas**, VIC-SA	-		OTWAY Gas Development

** Seagas under construction - Producer/user financed

Minor pipelines constructed during '90s

Pipeline Name & State	Built	Regulatory status	Basis of decision to construct
Cannington, Qld	1998	Not covered	Contract with BHP Mine.
Riverland, NSW	1999	Not covered	Greenfields Gas Market
Katnook, Vic-SA	1991	Not covered	Katnook Gas Development
SWP, Vic	1999	Rolled into GasNet	Security of Supply
Tumut**, NSW	2001	Not covered	Greenfields Gas Market
Port Hedland, WA	1998	Not covered	User built to Powerstation

**Govt. owned and developed pipeline

Transformation of gas transmission industry: 1990-2003

- Three pipelines built anticipating regulation:
 - Interconnect NSW - VIC
 - South Western pipeline, Vic
 - Central West pipeline, NSW
- Expansion outcome of radical industry change: privatisation and private sector development
- Expansion not facilitated or supported by regulation



Pipelines in planning

Pipeline Name & State	Basis of decision to construct
Telfer, WA	Contract with Telfer Mine
CH4, Qld *	Contract with Power Station
Blacktip to Gove, NT	Proceed only on basis of sufficient foundation revenues contracted
Tamworth, NSW	Proceed only on basis of sufficient foundation revenues contracted
West Kimberley Power Supply	Proceed only on basis of sufficient foundation revenues contracted

* Government agency owned



Gas transmission industry 2003: impact of Code

- Negative investment climate, litigation
- Pipelines originally covered - 22 successful obtaining revocation, 2 seeking revocation
- Overseas businesses exited Australia
- Disputation and controversy on covered pipelines
 - NT Gas, DBNGP, MAP, GasNet, MSP



Gas transmission industry 2003: impact of Code

- Amadeus/ NT Gas pipeline
“..draft decision analysis suggests that if the access arrangements were approved... consumers and industry would face excessive energy charges...which could discourage investment and harm the NT’s economy”

(final decision) *“As ..pipeline is fully contracted until 2011, it is unlikely that reference services will be sold in this access arrangement period.”*



Gas transmission industry 2003: impact of Code

- Dampier to Bunbury pipeline, WA
 - Epic purchased from State Govt. for \$2.4B
 - tariff reductions, \$125M capacity expansion
 - OffGar draft decision demands lower tariffs
 - Supreme Court admonishes OffGar: failure to consider circumstances of DBNGP purchase
 - OffGar trying to pass legal costs on to Epic
 - Final determination by OffGar likely to be appealed



Gas transmission industry 2003: impact of Code

- Moomba-Adelaide pipeline: appeal
- GasNet, Vic: second determination, under appeal
- Moomba-Sydney: coverage revocation application
- Qld: NCC seeking to dismantle derogations, recognised in 1997 Access Agreement:
“..reference tariffs..will be..taken from the existing access principles..These will not be subject to... ACCC scrutiny until..nominated review date..”



Gas transmission industry 2003: impact of Code

- GGT, WA: owners' defending their rights under state agreement
- Only three pipelines carrying gas/ tariffs devised under Code
 - MAP
 - CWP: Insignificant
 - GasNet: VENCORP imposed costs resulted in total cost of haulage greater than 5 years ago



Regulation: achievements and shortfalls

- Most pipelines not regulated
- Regime costly, inefficient, intrusive
- No effective reduction in cost of gas transmission
- Interpretation of Code has led to uncertainty and capital revolt
- Growing body of legal precedent
 - EGP revocation
 - DBNGP, “Regulator erred at law”



Regulation: achievements and shortfalls

- 3 largest pipeline owners public positions on new pipeline developments:
 - Duke Energy, no new pipeline investments
 - Epic Energy, will build, but only for foundation contracts with no additional capacity
 - APA, will build with additional capacity, but only if capital for capacity is fully risked, and tariff for capacity is no less than tariff for foundation contracts



Regulation: is it necessary?

- Present model assumed:
 - Australia same as UK, US, Europe
 - gas transmission same across all states
 - gas transmission same as natural gas distribution
- Australia an immature market
- Each pipeline is different
- Paper recommended 15 yrs “regulatory holiday” for Greenfields



Reviewing the Gas Code: outcomes for investment certainty

- Code may not need to change greatly
- Reduce scope for inappropriate regulatory discretion
- Need to understand impact of Code on investment
- Assess costs and benefits of regulation
- Test distribution vs transmission



Reviewing the Gas Code: outcomes for investment certainty

- Consider validity of public assertions of monopoly abuse, market power & benefits to industry of regulation
- Assess relationships between regulators
- Accountability of regulator(s)
- Alternative policy approaches to transition issues



Reviewing the Gas Code: specific changes

- Clearly understood objects clause
- Modified coverage test
- Range of access pricing models
- Effective merit appeals
- Clearer incentives for efficiency and productivity
- Eliminate inflammatory nonsense in media



Conclusion:

- Benefits from competition reform in gas have not resulted from regulation of transmission pipelines
- Regulation inhibits development of a sophisticated, innovative market based on a national grid accessing Australia's vast supplies of natural gas
- Regulation should provide incentives to build and operate better and cheaper pipelines
- Pipelines are essentially (as yet) unregulated



A scenic landscape featuring a wide, reddish-brown dirt road that curves through the foreground. The road is flanked by sparse, dry-looking vegetation, including several trees with yellowish-brown foliage. In the background, a large, rounded hill or mound is covered in similar vegetation. The sky is a clear, bright blue. The overall scene suggests a rural or semi-arid environment.

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J. K. McDonald
Managing Director
Australian Pipeline Trust

Australian Energy and Utility Summit – 10 July 2003

TOPIC: Improving the gas access regime and the National Gas Code

- What regulatory changes are required to encourage development of the gas Pipeline network and encourage investors?
- The need to balance short and long-term consumer interests
- What specific mechanisms need to be introduced?
- Benefits to the industry and consumers

Slide 1

I believe that in our drive to achieve energy market reform we should be working towards a common vision: the prosperity and economic security of Australia. What I want to discuss today is whether or not the regulation of gas transmission pipelines, in its present form, contributes to that vision. The development of natural gas infrastructure connecting markets and competitive supplies of natural gas is important because natural gas could become a driver of economic growth. Natural gas offers a genuine alternative energy supply to compete with liquid and solid fuels, and electricity. And priced correctly, gas can act as a price marker for energy to industry.

Natural gas is a clean, efficient, competitively priced energy source that Australia has in abundance, albeit in the wrong places. When the Australian gas industry began a process of reform in the early 1990s through privatisation and the introduction of competition, great hopes were held for a surge in natural gas usage and the development of a sophisticated national market. By 1997, the year the present regulatory regime (the Code) came into effect, a national market had begun to take shape as pipelines crossed state borders and gas was delivered to new industries and their communities. However, the introduction of the Code and its selective interpretation by Regulators created uncertainty and raised the spectre of investment risk. The development of a national gas grid has effectively stalled over the past five years as evidenced by investor disenchantment, suboptimal plans for new pipelines, extensive litigation to defend property rights, and foreign companies, who purchased privatised pipelines during the 1990s, exiting Australia. Further evidence of private capital disenchantment is that government agencies have reinvested or are about to reinvest in gas transmission pipelines.

In 2003 the gas transmission industry is looking forward to the long awaited review of the National Gas regime, including the National Gas

Access Code by the Productivity Commission, announced by the Federal Treasurer on 13 June. With 12 months to complete this review, the Australian Pipeline Industry Association will be actively involved throughout the various stages of deliberation. It's our hope that the review will address our concerns and install the correct incentives for investment in natural gas transmission, in step with a broader vision for economic growth based on the realisation of our natural gas resources for domestic consumption as well as for export.

Today I will examine the issues we face in greater detail, before putting forward key initiatives that the Australian gas pipeline industry believe will address our concerns and give new impetus to the growth of natural gas usage in Australia.

Slide 2 (map)

The transformation of the gas transmission industry: 1990-2003

During the 1990s the gas transmission industry was transformed by two significant developments. Firstly, the privatisation process where governments of all persuasions in almost all states set about maximising the sale value of government assets. In response, willing, and in many cases naive buyers were encouraged by the rhetoric of government agents and their advisers. With gas transmission pipelines potential buyers made the usual pricing assumptions about the market volumes of gas they might transport, life of project and revenues they would expect to support their bid. They also made assumptions about what the stated policy promise of light handed regulation really meant.

Following the sale of the Moomba-Sydney pipeline in 1994, there was a stampede of asset sales in Queensland, Victoria, South Australia and Western Australia.

Slide 3

Pipeline privatised during 1990s

Pipeline Name & State	Year sold	Regulatory status
MSP, C'wealth	1994	Covered – revocation application
PASA, SA	1995	Covered – under appeal
SGP, Qld	1997	Covered – tariff derogated
DBNGP, WA	1998	Covered – Supreme Court action, draft decision reissued, decision to be appealed
GasNet, Vic	1998	Covered – under appeal

Governments banked a total of \$4.55B through the sale of gas transmission pipeline assets – “accelerated taxation” is one way of thinking of it. You will notice that all those pipelines are covered by the code – Every decision is in dispute: one has already been to the courts and two more could get there soon if things don’t change.

When the Code was established the new owners of privatised pipeline assets anticipated changes in the gas market. Without exception, the new pipeline owners lowered their tariff compared with what was previously charged by government. It was their serious expectation that the Code provided a mechanism for the reasonableness of their tariffs, terms and conditions of haulage, open access policies and their non-discriminatory treatment of customers, to be accepted as the basis of their business. That has not been the experience.

The second feature of the gas transmission industry transformation was expansion by investment of the reach of natural gas, including the physical connection of markets in South East Australia in anticipation of a major freeing up of the deregulated gas markets and gas supply.

The emergence of new players in the sector, and shifts in the business activities of existing players, led to a renewed focus in the development of pipeline business opportunities. Competition for the development of new pipelines gained momentum with all major participants vying for new infrastructure and market opportunities irrespective of state borders.

Pipeline companies made unilateral decisions to invest to expand existing systems, or to unilaterally develop new Greenfields projects. The 1990s also saw pipeline projects facilitated by state governments through a bid process for the construction of new pipelines – in Western Australia the Goldfields Gas Transmission pipeline, and in Queensland the Carpentaria pipeline, Ballera to Wallumbilla pipeline and the expansion of the Roma-Brisbane system were all built on this basis.

Finally, there was direct state government agency investment in pipelines with the South West pipeline in Victoria, the McArthur River pipeline in the Northern Territory, and the Mid West pipeline in Western Australia.

Much of the investment in gas transmission infrastructure in the mid 1990s took place in anticipation of light-handed regulation. The growth in new pipeline developments occurred essentially without regulated tariffs, which many didn’t think would eventuate. The exception was the

Victorian gas transmission system. In Victoria the old Gas and Fuel system was unbundled and driven to work as a Government Business Enterprise (GBE) before a deferred sale, and sold with regulation attached.

The ACCC has argued on many occasions that pipeline companies have continued to invest in pipelines, therefore their complaints about the code may be ignored. Let us explore that proposition.

Slide 4

Major pipelines constructed during '90s

Pipeline Name & State	Built	Regulatory status	Basis of decision to construct
ICP, NSW-VIC	1998	Covered – rolled into EAPL and GasNet	Marginal economics market connector
EGP, NSW-VIC	2000	Not covered – revoked on appeal	Negotiated contracts
CWP, NSW	1998	Covered	Greenfields Gas Market
MWP, WA	1999	Not covered	Contract with PMA Mine
GGP, WA	1996	Covered – tariffs from state agreement	State agreement

Slide 5

Major pipelines constructed during '90s

Pipeline Name & State	Built	Regulatory status	Basis of decision to construct
CGP, Qld	1998	Covered – tariff derogated	Agreement with Government.
SWQP, QLD	1998	Covered – tariff derogated	Agreement with Government.
RBP LOOP, QLD	2003	Covered – tariff derogated	Agreement with Government.
Tasmania	2002	Not covered	
Seagas**, VIC-SA	2003		OTWAY Gas Development

**Seagas under construction – Producer/user financed

Slide 6

Minor pipelines constructed during '90s

Pipeline Name & State	Built	Regulatory status	Basis of decision to construct
Cannington, Qld	1998		Contract with BHP Mine.
Riverland, NSW	1999	Not covered	Greenfields Gas Market
Katnook, Vic-SA	1991	Not covered	Katnook Gas Development
SWP, Vic	1999	Rolled into GasNet	Security of Supply
Tumut**, NSW	2001	Not covered	Greenfields Gas Market
Port Hedland, WA	1998	Not covered	User built to Powerstation

**Gov't owned and developed pipeline

Together with the pipelines listed above, there were smaller pipelines, connections and spurlines constructed, totalling around \$4.5B in investment. About 650 kms of pipeline built with tariffs determined by Code: 6000 kms with tariff not determined by Code.

Slide 7

Transformation of gas transmission industry: 1990-2003

Only three pipelines were built through the 1990s anticipating tariffs affected by coverage. The first was the Interconnect linking the NSW and Victorian gas systems: 50% of capital is "rolled into" each of the GasNet and EAPL capital base. The second was the South Western pipeline of Victoria which was an initiative of the Victorian Government in response to the Longford gas disaster. The pipeline was built to connect the Victorian gas system with gas storage facilities. The circumstances of its construction are therefore exceptional. The third pipeline was the Central West pipeline in New South Wales, which in retrospect should never have been regulated, as the costs of regulation exceed any benefit. Now owned by the Australian Pipeline Trust (APA), we should seek to have coverage removed. However as the ACCC has long held the regulation of this pipeline as an example of how a Greenfields project might work, we suspect the NCC would not easily agree.

The expansion of Australia’s gas transmission network has been a very positive outcome of radical industry change: privatisation and private sector development. Expansion has not been facilitated or supported in any way by the regulatory regime imposed in 1997.

Indeed, the ACCC published Greenfields Guidelines indicating how pipelines in the future might be covered under the Code in answer to common voice of owners that new pipelines would not be built if subject to the Code. These Guidelines are themselves an interpretation of the Code with no future guarantees as to the opinion of the next generation of Regulators, thus adding to the concerns of investors – not diminishing them.

Slide 8

Pipeline in planning

Pipeline Name & State	Basis of decision to construct
Telfer, WA	Contract with Telfer Mine
CH4, Qld *	Contract with Power Station
Blacktip to Gove, NT	Proceed only on basis of sufficient foundation revenues contracted
Tamworth, NSW	Proceed only on basis of sufficient foundation revenues contracted
West Kimberley Power Supply	Proceed only on basis of sufficient foundation revenues contracted

* Gov’t agency owned

Of the pipeline projects either in planning or under construction at present, the Telfer pipeline (440km pipeline for a gold mine-based power station), and the Townsville pipeline (391km pipeline also for a power station) assume they will not be covered by the Gas Code. The possible 1000km pipeline from Blacktip to Gove, the on-again off-again Tamworth pipeline and the West Kimberley Power Supply project will proceed only on the basis of sufficient foundation revenues being contracted. In all examples, economic regulation is viewed as a risk and the pipelines are being built in spite of regulation, not because of regulation.

Slide 9

The gas transmission industry in 2003: the impact of the Code

Let's now consider the features of the industry and pipeline development since the introduction of the Code in 1997.

Five years on and what do we have?

- A negative investment climate, capital withdrawn, suboptimal gas infrastructure plans, asset values written down and litigation.
- Of the pipelines originally covered in the Code, approximately twenty-two have successfully sought revocation of coverage and two are currently seeking revocation of coverage.
- Investors have exited Australia – Nova, Trans-Canada Pipelines, West Coast Energy, GPU, PG&E and Coastal. Dominion has been attempting to sell its investments in the Epic system for three years. Three remain: El Paso, Duke Energy and CMS.
- Pipelines presently unequivocally covered include NTGAS, the Dampier to Bunbury, the Moomba to Adelaide, the GasNet system and Moomba to Sydney. They are all the subject of dispute and controversy.

Slide 10

(cont'd – Gas transmission industry 2003: impact of Code)

- The Amadeus/ NT Gas pipeline, 1600km, 17PJ for the NT Government. It has taken nearly 3 years for a final decision on tariff to be reached. At the time of the release of the Draft Decision, back in May 2001, the ACCC attacked NT Gas in a press release: “...draft decision analysis suggests that if the access arrangement were approved in its current form, consumers and industry would face excessive energy charges in the future, which could discourage investment and harm the Northern Territory’s economy.” Such public statements are both inaccurate and unhelpful. NT Gas did not believe the pipeline should be covered (nor did the NT Government) and several hundred thousand dollars later the tariffs determined in the final decision did not differ greatly from those sought by NT Gas. ACCC revised its tariff upwards by 52% from the draft decision. Furthermore to quote from the final decision: “As the pipeline is fully contracted until 2011, it is unlikely that reference services will be sold in this access arrangement period.” Needless to say, no media fanfare accompanied this illuminating news. With third party reference tariffs therefore irrelevant for at least eight years, the ACCC looked to the arrival of Timor Sea gas into the Northern Territory at a future point in time and decided that to be a trigger event for a new rate case at that time.

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(cont'd – Gas transmission industry 2003: impact of Code)

- The Dampier to Bunbury pipeline, Western Australia. When the state government owned the pipeline it charged over \$1.20 per GJ for natural gas haulage. With the sale of the pipeline to Epic Energy the state government banked a cheque for \$2.4B. As part of the sale process the new owners agreed to drop the tariff to Perth to \$1 over time, and proceeded to do so. But not 1cent was passed on to consumers in Western Australia. The reduction was absorbed by then government-owned Alinta Gas and went to underwrite another government asset sale. Furthermore, a protracted legal battle has developed over the access arrangement for the DBNGP with a legal precedent set when the Supreme Court of Western Australia admonished OffGar, the Western Australian Regulator, for erring at law in the interpretation of the Code because he chose to ignore provisions of the section 2.24 of the Code. Those provisions require the Regulator to consider the legitimate business interests of the owner of the pipeline and his investment in the pipeline as part of the decision making process.

Slide 12

(cont'd – Gas transmission industry 2003: impact of Code)

- The Moomba Adelaide Pipeline, which has a final determination currently under appeal.
- the GasNet system, Victoria, which is the only pipeline to have a second Determination and is under appeal.
- and the Moomba Sydney pipeline system, presently subject to a coverage revocation application and awaiting a Ministerial decision based on the concept that competition exists between it and the Eastern Gas Pipeline. As the Eastern Gas Pipeline is not covered by regulation, our contention is that coverage of the competing Moomba Sydney Pipeline should be revoked.
- In Queensland there is a group of pipelines in a “half-way” house. At the time the Code was installed four pipelines in Queensland received a derogation from the Code through a specific provision of an Inter-government Agreement for various periods of time. Those derogation’s are now under threat from the National Competition Commission. As agreements entered into with the Queensland State government, those four pipeline owners had every confidence in their sanctity. The Natural Gas Pipelines Access Agreement of 1997, specifically acknowledges the existence of the derogations. To quote from the Agreement: “reference tariffs (and reference tariff policy) will be taken from the existing access principles...These will not be subject to ...ACCC scrutiny until the nominated review date expressed in the individual access arrangements.”

The ACCC has rightly decided that while those pipelines are derogated the ACCC can have no part to play in the management of those tariffs. However, the National Competition Commission (NCC) seems to be trying to dismantle those agreements and a recommendation is currently before the Minister outlining why they consider the Queensland system to be an ineffective regime.

Slide 13

(cont'd – Gas transmission industry 2003: impact of Code)

The Goldfields pipeline in Western Australia is also the subject of a state agreement and a substantial dispute is running over the issue of owner’s rights under the state agreement, versus the impact of the Code.

So, five years since the code was introduced, only two major pipelines as of 30 June 2003 are carrying gas with tariffs devised from the Pipeline Access Code. The first is the Epic Moomba Adelaide pipeline.

The second pipeline system is GasNet, Victoria. In Victoria the price of hauling gas has been reduced (although GasNet is appealing ACCC's ruling). However the presence of the imposed gas management entity VENCORP and its charges results in the total cost of haulage being greater than it was five years ago.

There was a headline in the Sydney newspapers in the last week of June: "IPART increases price of gas by 8.5%". This was reported to be due to the well-head price of gas rising by up to 80 cents per GJ. Yet in Victoria, GasNet is arguing with the ACCC over less than 2 or 3 cents per GJ, and in the Moomba Sydney system here in New South Wales, the difference between what we seek as tariff and what the ACCC appear to be determining, amounts to about 15 cents per GJ.

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Regulation: achievements ad shortfalls

Has Australia benefited from regulation of gas transmission?

- Most pipelines are not regulated
- Management of the code is costly, inefficient and intrusive
- There is no effective reduction in the cost of gas transmission, where regulation is applied and no significant benefit is anticipated
- We have had a revolt of capital, despite the ACCC falsely asserting that we're still investing and that therefore we accept the regime.

There has been a growing body of legal precedent supporting industry assertions. From the decision by the Competition Tribunal upholding revocation of coverage of the EGP, to the decision last year by the Supreme Court of Western Australia admonishing the state regulator for erring at law when it failed to give due consideration to the circumstances surrounding the sale of the DBNGP in its determination of tariff arrangements, and there are appeals pending with the potential for further precedents.

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(cont'd - Regulation: achievements and shortfalls)

The Code and the discretion it gives to regulators has resulted in uncertainty.

Consequently, the three largest owners of pipelines have distinct and public positions on new pipeline developments. Duke Energy announced they won't invest in any more pipelines under the present regime. Epic Energy's last stated position is they will build new pipelines, but those pipelines are only for foundation contracts and they will not contain additional capacity that could be subject to coverage. Finally we at the Australian Pipeline Trust (APA) will build new pipelines and install capacity for third party use. But that will only occur if two conditions are met. Firstly, capital for that capacity must be recognised as fully at risk. Secondly, the tariff for that capacity must be no less than the tariff for foundation contracts over the life of the project.

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Regulation: is it necessary?

I don't think so. As an industry we don't mind the surveillance but we object to the inefficiencies, the costs, and the nonsense, and it is difficult to see where the public benefit test has been met in any of the decisions made so far.

I contend that our present regulatory model wrongly assumed that natural gas transmission in Australia was the same as natural gas transmission in the United Kingdom, Europe and the United States; and it assumed that transmission was identical in all states of Australia and indeed in all pipelines. It would appear natural gas transmission was thought to be the same as natural gas distribution or at least so similar that we could produce a set of rules based on theoretical replication of competition and some North American experiences, apply them across the board and then move on.

This "one size fits all" approach is patently unworkable to those who know gas transmission pipelines in Australia. Witness to this is the fact that (despite industry protests), the original list of pipelines targeted for regulatory coverage included all pipelines. This list was attached to the Code as part of the Code documentation. There was clearly an expectation by bureaucrats that regulatory coverage would be a simple process and relatively inexpensive and universally applied.

Australia is an immature gas market. The gas transmission industry has less than 100 customers, each with significant market power. Each pipeline is different. There is no similarity either in the climates of the markets they serve or the sources of gas. Differing conditions and circumstances require different consideration. The ACCC has recognised that a different interpretation is needed for Greenfields projects, a view

further supported by the Parer Energy Market Review which recommended a 15 year holiday for Greenfields projects.

What needs to change? We won't be able to change the glee of the bureaucrats charged with the sale of those assets in the past; governments have long since banked the cheques from those sales. We also can't change the prices that were paid. But we can stop pretending that it didn't happen.

What we can do, and have the opportunity to do under the Review of Gas Access arrangements is to discuss the shortcomings, the costs and the lack of wisdom of the present system, and we can change the way the present system is interpreted.

Slide 17

Reviewing the Gas Code: outcomes needed for investment certainty and growth

A review of the Code by the Productivity Commission is about to start and my industry's view is in part that the Code may not need to change very much.

What needs to change is the interpretation of the Code by regulators. It is fully open to regulators under the Code to look at the reasonableness of a proposition put to them by owners and accept the rate case put forward – but they choose not to do so. In the case of the Eastern Gas Pipeline (no longer covered) Duke attempted to satisfy the need for public surveillance of the business with an undertaking under Part 3A of the Trade Practices Act. But to paraphrase the position the Regulator put to Duke Energy: if you submit an application under Part 3A we will make it the same and treat it the same as if the application was made under the Code. Duke decided to seek revocation of coverage and despite the work of the NCC and ACCC to prevent it, coverage was ultimately revoked under appeal to the Australian Competition Tribunal.

This discretion available to the Regulator is unacceptable to industry because it provides opportunity to the Regulator to behave capriciously.

There are a number of key issues that require focus in a review of the National Access Regime. Firstly, the need to understand the effect of the regime on pipeline investment: new infrastructure, capacity expansion, research and development. The review also needs to assess the costs and benefits of the regulatory framework. The view of the industry is that the current regulatory framework is too intrusive and too costly. We also

believe that sufficient differences exist between gas transmission and gas to warrant separate regulatory consideration.

Most critical is the need to reduce the scope under the Code for inappropriate regulatory discretion which, as I've discussed, introduces unacceptable levels of risk for investors and limits the scope for commercially negotiated outcomes.

Slide 18

(cont'd – Reviewing the Gas Code: outcomes for investment certainty)

The Review should also consider the validity of assertions publicly stated by regulators regarding monopoly abuse, the market power of pipeline companies and statements that regulatory returns are generous. The relationships between the various regulators should be scrutinised to assess whether linkages are efficient and appropriate, Regulators are not infallible and their economic modelling must be a transparent process and stand scrutiny by companies affected by their decisions.

Finally we need to consider alternative policy approaches to transition issues currently under litigation as a result of the Code, as well as giving due consideration to recommendations arising from the CoAG Energy Market Review, including scope for industry based mechanisms to achieve desired results. We also believe the regime needs to be reviewed periodically following the implementation of any outcomes from the review at hand.

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Reviewing the Gas Code: specific changes

Specifically, we need:

- A clearly understood objects clause to underpin and limit the gas access regime
- A modified coverage test for the application of access regulation to only apply when necessary and where competition will be substantially increased
- A range of access pricing models to include alternative light-handed models such as price-monitoring, price-service offerings, productivity based approaches.
- Effective merit appeals to recognise legitimate business interests and property rights of asset owners, improve accountability and lessen the risk of regulatory error.
- Clearer incentives for efficiency and productivity, in particular in the capital cost of pipelines.

- The elimination of inflammatory nonsense in the media positioning of Regulators.

Slide 20

CONCLUSION:

The benefits that have flowed from competition reform natural of the gas transmission industry have not been the result of regulation of gas transmission.

Pipeline investors have contributed greatly to the transformation. This industry invested nearly \$10 billion through the 90's in pipeline. Regulated tariffs do not yet apply to the vast majority of them.

Australia has vast reserves of natural gas, which should be accessible to industry and communities across the nation and delivered through a sophisticated, innovative market that promotes real choice between gas supplies and alternative energies. Because of the importance of energy to the Australian economy, a thriving competitive energy market providing consumers with choice, security of supply and price competition would bring substantial national benefits.

The next pipeline of significance for this country will be bringing a new gas supply to the south and eastern states and may cost as much as \$2-3B. It will come from the north or west of Australia.

It will, of necessity be underwritten by very firmly negotiated contracts and/or the right to build it will be bid by either governments or the owners of the gas it carries. The construction risks, finance risks and market risks for the pipeline owner will be substantial.

We need a regime that encourages the Pipeline Industry to build it better and cheaper than anywhere on earth. The present regime does not come close.