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Mr John Martin
Commissioner
Australian Competition and Consumer Commission
P.O. Box 1199
Dickson ACT 2602
31st January 2003

Dear Mr Martin,

The Energy Users Association of Australia is pleased to comment further on the Draft Greenfields Guideline following our attendance at the Forum that was held by the Commission at its Melbourne offices on 19th November.

We are generally supportive of the overall conclusion drawn by the Commission: that the flexibilities of the Gas Code and Part lllA of the Trade Practices Act (the current regulatory framework) are sufficient to accommodate the concerns of the pipeline industry regarding new investment in pipeline infrastructure. We note that there was no sound argument put forward by attendees at the Forum to counter the Commission's conclusion.

However, we have a concern to see competitive and reliable gas continuing to be provided to end-users into the future and recognise this requires adequate investment in pipelines. Greenfields pipelines are an important component of this objective and we would want to ensure that the Commission's treatment of them reflects this need.

Additionally, whilst we agree with a need to have some regulation over monopolies, including greenfields pipelines, we do not want to see regulation burden investment in new pipelines and therefore prefer regulatory treatment that caters adequately for this need. Our reading of the Guideline indicates that the Commission has taken this point into account, particularly as it relates to the consultation process and the requirement for provision of information.

We have seen significant investment in new transmission pipelines in recent years and while there have been a number of legitimate concerns expressed by investors, we feel the Guideline offers a reasonable balance between the needs of pipleline owners/operators/financiers on the one hand and pipeline users/gas consumers on the

other and provides for an adequate level of certainty in the way the regulatory process is to operate.

From a consumers perspective, it is essential that the owners of greenfields pipelines price haulage at a level that is competitive but also recognises their unique position and added risks. The Guideline seems to adequately cover the range of increased risks faced by greenfields pipeline investors and provides detailed guidance on how the provisions of the existing regulatory framework can help a prospective investor address and mitigate relevant risks. This includes the role of foundation contracts in underpinning new investment, debt providers' information requirements to assess all risks associated with the project, use of the capital asset pricing model in determining the weighted average cost of capital, and project finance/ financial engineering/risk management techniques to reduce specific risks.

In addition, we would comment on a number of key issues covered in the Guideline as follows:

- Treatment of systematic and specific risks

The CAPM approach recognises risks of a systematic or market related nature. Compensation for specific (non-systematic) risks is included in the cash flows. This approach compensates for non-systematic risk transparently and is supported by our Association. We have always been supportive of treatment and analysis of service provider information that is sufficiently detailed to allow users to fully understand and assess it.

- Financial risks

We recognise that financial risks could occur in both the construction and operational phases of a pipeline and those costs that can be recognised and are justified should be compensated for in the regulatory framework.

- Construction risk

We recognise that construction risks are common to both regulated and non-regulated industries and are supportive of the concept that prudent commercial mechanisms be used to mitigate construction risks, ie. assign risk to the party best placed to handle it.

- Capital base uncertainty

The Gas Code provides for the initial capital base for new pipelines to be valued at actual cost (s.8.12). There is no scope for regulatory optimisation (optimal pipeline configuration / sizing considerations). The Commission's view that a forecast initial capital base be used when determining the initial reference tariff in conjunction with an appropriate mechanism to adjust the tariff when the actual capital cost is established with

certainty seems to be workable, although this will only really be known when implementated and we would be interested in the views of others on this point.

- Operational risks

We agree that legitimate prudent costs that are identified and quantifiable by the service provider be reflected in the operational cash flows of the pipeline eg. where an operator chooses to self-insure, prudent actuarially determined premia can be reflected in the cashflows. We stress that these must be "legitimate" and accurate, as well as determined in an open and transparent manner with opportunity for scrutiny by users.

- Demand uncertainty

The EUAA recognises that there can be uncertainty in determining demand growth forecasts for greenfields pipelines. We note that the Code provides an element of flexibility to allow for the determination of a reference tariff regime that is appropriate to the specific needs of each pipeline system. At this stage, we can see little argument for altering it specifically to cater for greenfields pipeline access applications or moving away from it altogether.

- Benefit sharing

We note that the sharing mechanism proposed by the Commission when demand exceeds a pre-set threshold is symmetric in that the costs to the pipeline developer of abnormally low demand is diminished with potential users of the pipeline sharing those costs in higher future tariffs. We feel it is important that the diminished risk to the developer of the pipeline be taken into account by the Commission in its assessment of any access application.

In the current gas reform context we feel it would be remiss not to comment on the greenfields pipeline recommendations contained in the Parer Report.

On the issue of pipeline regulation we are concerned at some of the proposed recommendations. We agree with the Panel that the level of regulation for existing pipelines has been appropriate and has not impeded investment in new pipelines. In particular, we note the comment in the report that "The pipeline industry has expressed concern that regulation has resulted in reductions of asset value and shareholder returns with the potential to limit investment in new projects and potential undersizing of new pipelines to avoid third party access regulation. The Panel wrote to the APIA, asking for evidence of prospective pipelines not proceeding solely because of the operation and application of the Gas Code. In reply, the APIA did not identify any such pipelines and acknowledged that there are a suite of barriers to new transmission pipeline development."

Certainly, significant additions to the nation's pipeline infrastructure have occurred in recent years and these have assisted in enhancing the competitiveness of gas markets. In respect of new pipelines we agree that the Gas Code does not adequately address this area in its present form so that a review of the Code needs to be carried out to address this issue. We do not feel the Code needs to be reviewed in any wider sense as it has performed its role satisfactorily since its inception.

We are concerned, however, with some aspects of the Parer Report recommendations on greenfields pipeline regulation, particularly the proposal for commitment to a fifteen-year economic regulation free period. This matter is already the subject of a review by the Commission and we believe the duration of any regulation free period should be left unspecified until the issue is thoroughly debated.

We look forward to receipt of the final guideline from the Commission as soon as it is available.

Yours sincerely

Alan Reichel
Director-Gas Markets