Energy Futures – *Future of gas in Australia: a new paradigm?* - Melbourne 19 May 2016

The prospect of very big gas price increases or even shortages has made the gas market a hot topic. The possibility of such outcomes arises from the connection of Australia's domestic market with the broader regional market via LNG exports from Queensland. The Australian Competition and Consumer Commission (ACCC) has delivered its report on the competitiveness of wholesale gas prices in Eastern and Southern Australia. The ACCC's conclusions and recommendations have been eagerly anticipated and will set a direction for the role of gas in Australia for some time to come. This Energy Futures public forum featured Rod Sims, the Chairman of the ACCC, who will discuss the Commission's report. He was joined by a panel of key stakeholders from the gas sector who responded to the Report from their own perspectives: Is this a fair set of conclusions? Will the recommendations address the concerns of producers, pipeliners and customers? What does this report mean for the future of gas as a key energy source?

Moderator: Dr Leslie Martin, Lecturer, Department of Economics, University of Melbourne

Speakers: Rod Sims, Chairman, ACCC
Mark Grenning, interim Chair, Sustainable Energy Futures, University of Queensland
Nevenka Codevelle, Company Secretary & General Counsel, APA Group
Damian Dwyer, Director of Economics, APPEA

ROD SIMS: Thanks very much Leslie and thanks very much to the Grattan Institute for this opportunity and Grattan Institute's input into our study, we appreciate that. It's quite an amazing backdrop of course to the gas industry in that we had three $20 billion new projects go ahead in Queensland, so we had the east coast gas market that was contained, there were no exports going out of the east coast, so there was no export link to pricing then bang, all of a sudden you've got three $20 billion projects. It's quite amazing. I've been around a fair while and I've never seen anything like that and, of course, it had a major impact on the market. I think it's important to understand the background to this.

So you had the gas users complaining loudly during the 2012 to 2014 period that they could not get gas and then you had the gas suppliers saying yes they could, they just don't like the price. The government was caught between the two, didn't know how to handle it, didn't know how to respond really because they were getting completely conflicting positions, and while there have been a lot of studies done on the gas market, a lot of studies done on the gas market, none of those could get to the bottom of that. So the main reason we were asked to do this study is because, amongst our many roles, we enforce the Competition and Consumer Act which means we use our compulsory information-gathering powers. The Productivity Commission has them as well but they've never used them. We use them every day of the week. Our civil notices are not one you want to receive, but they allow us to get information, which is core to how we do our work. So that's why it came to us and that was the key backdrop.

What we found was that for the period of 2012 to 2014 the users were right, in essence they could not get gas offers due to a range of circumstances. The LNG was a good part of it, but there were other factors as well, so they could not get gas. Now they can get gas, there are gas offers in the marketplace, but they're higher price, they're shorter duration, they're very much tied to terms and conditions than they had before and there are very few sellers, there's not the same market. You go out and say, "I want gas", once upon a time a whole lot of people would come rushing through the door. Now you say, "I want gas" and you've actually got to go out and chase the sellers. The three topics I'll deal with tonight were the three topics in the report, one's about supplier, two is about pipeline regulation and three is about transparency.

So with supply, really the way we described it in the gas report, you've had a triple whammy which, again, is very unusual. So three LNG projects combined they were then short gas, particularly one to three, so they went ahead on the presumption they would very likely need domestic gas to fulfil their contracts; that is take gas that was otherwise targeted for the domestic market to fulfil their expected contracts. Now they may have hoped at certain times they could have found more gas and there's some sense in which some of the exploration endeavours didn't quite yield what they were hoping, but I think a fair remit at that time was they knew, certainly one of them knew and therefore they affect more that reliance on gas, so some of the gas that was otherwise going to go domestically was taken away. Secondly, that old reason why we have commodity price cycles, the price of oil fell and companies immediately were cash-short. So the cash they were used to getting they didn't have and so they cut back on their exploration, and even though gas prices were high domestically, given oil prices were low the future expectation of gas prices was reduced and so, as I always keep saying, that's why we have price cycles.

So the price went down and people stopped exploring until the price goes back up again. So the decline in the oil prices has had a significant impact on exploration and, of course, the third part of the triple whammy is we've got the moratoria in Victoria and an effective moratoria, we don't call it, but it has a very similar effect in New South Wales and a potential moratoria in the Northern Territory. But the New South Wales and Victorian policies have clearly stopped gas projects that would have boosted supply to the domestic market. The outlook for supply, our report given access to all the information we had, the outlook is that we believe there's enough gas to 2025 to meet LNG export contracts plus domestic supply, but that very much depends on predicted developments going ahead. There's no reason to think they won't and there are plans for them to go ahead even with the current price, so it should be okay but there are no guarantees. But it's a reasonably tight supply situation. The bigger issue is just having a small number of suppliers down south and that has a very important effect on price and I'll illustrate it this way.

If you're a seller of gas in a market, let's say you sell gas into the Victorian market, if you've got many people competing against you to sell that gas you won't sell at a price less than what you could sell it up into Queensland to the LNG projects. That is, you won't sell it at less than LNG net back in Queensland minus the cost of getting it there. So why should you sell it domestically below a price you can sell it to this almost endless LNG market? If, on the other hand, and this is the reality, you've got very few sellers, then they know the buyers' alternative is rather than go to another seller, which is very difficult, is to go to Gladstone and get gas that would otherwise be used for LNG. So the buyer alternative when there's a tight market is the LNG price plus the cost of getting the gas from Queensland. So if you've got a lot of suppliers versus you don't have any suppliers there's a big gap between the price that results in the market. We judge that as anywhere up to $4 a gigajoule, which is a hell of a lot.

So not having a competitive market in the south has boosted prices significantly. We've said in a report that each $2 increase in price increases the price for households in New South Wales by about 5% and in Victoria by 11%, so the effect could be double that, but it's a bigger effect on the commercial industrial users. When you start scratching the gas market, we've got a surprisingly large number of manufacturers who rely on gas. Some of them have just got no alternative, it's a direct input feed into their production process, fertilizers for example. Some of them spend so much money configuring their plan for gas that they effectively have no choice either, so the price impact on them is even larger. So not having enough sellers of gas in Victoria and New South Wales, what Queenslanders call the southern market, anything south of the Queensland border, does increase the price of gas quite significantly even if there's enough gas.

So it's clear we need not only more gas, but we need more gas suppliers and so we basically said three things and here I'm, in a sense, quoting from our report because this is now a politically contested issue and as a humble public servant I'm not going to get into the middle of a public political debate in an election campaign. But what we said was gas reservation is not helpful policy, we don't need any more disincentives to production and, of course, you have the effect of discouraging some projects that are purely domestic, and there are many of those. So we argue quite strongly against gas reservation. Secondly, and this was the tricky bit, we said rather than blanket moratoria or blanket regulatory rulings, try and do things on a bit more case by case basis and really weigh up the benefits of extra gas versus not on a project by project basis. Now we went that way because we're the ACCC, we don't have credentials to be advising governments on environmental issues, they're there to make their own choices about what the environmental obstacles are for gas, it's just not our territory. But we did want to point out that there are costs to the lack of development and, of course, in some places, particularly in Victoria, that moratoria is not just stopping coal seam methane, it's stopping conventional gas that if you didn't have coal seam methane would probably be going ahead anyway. That's where we came out on that.

The third thing we said is not so much a recommendation, it's an observation that we, the ACCC, would be looking at the joint marketing arrangements between the Esso and BHP, the Gippsland Basin Joint Venture. So they jointly market, they're the biggest supplier, the ones with the most gas, in a sense you're dealing with them as a whole. They have an agreement to jointly market their gas, there's a provision of the law that says "Don't have agreements which have the effect of substantially lessening competition". We looked at this five or six years ago, at that time you had much more gas in the market, now you've got much less gas in the market, so what we're saying is we will launch an investigation into whether the Gippsland Basin Joint Venture arrangements do represent an agreement that substantially lessens competition, again, under the heading that part of what we found is we need more gas suppliers in the market. Pipeline regulation, we did find many pipelines have significant market power, we did find they weren't constrained by the threat of regulation. There are many monopoly pipelines, the classic one is the one that runs across the bottom of the Queensland border, the Southwest Queensland Pipeline, basically getting gas from Moomba to Brisbane. There's only one pipeline, a monopoly, in our view no threat of regulation so, of course, companies behave accordingly, and that's no criticism, that's what you'd expect them to do.

The view we formed is that the test for regulation is inappropriate, it's not fit for purpose. The test for regulating pipelines has leveraged off the standard Part 3a test, the test is will regulating this pipeline lead to a substantial increase in competition in either an upstream or a downstream market? That's the test you have to go on to regulate the pipeline. Now, that test, as someone who was intimately involved with all the this 25 years ago when the first access regimes came in, when Hilmer did his work, I've been following this issue for a long time, that is an regime designed for vertical integration, and Telstra was the forerunner of this. Telstra owns the copper wire and so Hilmer recommended an access regime, not the word "access". It's not a monopoly price regulation regime, it's an access regime. I own the copper wire; by giving access to the copper wire I facilitate competition downstream in the retail market. Telstra has to give access to its retail competitors. Telstra has every incentive not to give access to its retail competitors. So Hilmer brought in an access regime. He was quite clear that this wasn't necessarily the thing you need if you've just got a monopoly pipeline that's not vertically integrated.

So the whole issue is the access regime is talking about whether or not you get an increase in competition. What we've said is this is all about efficiency. So the classic way to look at this is if you had two pipelines running where the Southwest Queensland Pipeline runs and those two pipelines wanted to merge, would the ACCC allow them to merge? Very likely not. Why? Nothing to do with competition in upstream or downstream markets, you simply wouldn't want that level of market power; you want them to compete against each other. Here you've got a pipeline that is a monopoly and the test for regulation is talking about competition upstream and downstream, which is clearly not fit for purpose. So what we recommended is a new test for regulation,: has the pipeline got market power, is that likely to change and, in essence, will there be a boost to efficiency if the thing is regulated? There are a range of other recommendations which I won't go into much, but there are a range of other issues. Even when pipelines are fully regulated, a range of their services aren't regulated, which is just an anomaly that needs to be fixed.

The final area I'll talk to, we recommended a range of measures to improve transparency in the market. First of all, making sure that there's constituent ways to report what reserves and resources companies have got basin by basin. There's no way of doing that now, we can't when we use the information that's there. Secondly, we recommended a public calculation of the net back pricing because it does change, trying to find out what's happening in the international market, what's the cost of transport. So it would help buyers of gas if there was a visible net back pricing. We recommended four or five other measures to improve transparency, which I won't go into. Overall, to conclude, the market clearly needs more supply, it clearly needs more suppliers. The current test for regulation, we're not saying particularly to regulate a pipeline, we're saying if you want to regulate a pipeline you need a test that's fit for purpose and the current one isn't and there are a range of measures to make this a more functioning market, including a lot more transparency. And can I say that the test we have for regulation and the measures for transparency are things that are commonly applied in the United States, so we weren't re-inventing the wheel, we were pretty much copying what happens in a lot of overseas countries.

Thanks very much.

LESLIE MARTIN: Thank you Rod. We're next going to hear from the consumer advocacy side of the story, so I'd like to introduce Mark Greening. He's the Director and past Chairman of the Energy Users Association of Australia (EUAA) and he's had a long involvement in representing users' interests in governing structures and debates around electricity and gas markets in Australia. He's currently the interim Chairman of Sustainable Energy Futures at the University of Queensland and previously worked for Rio Tinto for 30 year, the last seven being the company's global energy supply subject matter expert.

MARK GRENNING: Thanks very much and thanks to Grattan and the Melbourne Energy Institute for inviting us here. Firstly, I want to begin by congratulating Rod and the ACCC on what is by far the best report ever written on gas in Australia over the last 20 or 25 or, perhaps I'm losing count, 30 because all the previous ones failed to address the basic problem of a lack of competition. The EUAA fought hard for this ACCC inquiry, we lobbied hard because only the ACCC could lift the confidentiality bar not just of gas suppliers, but also of the pipelines. We thank the Federal Government for answering that call and we were finally able to tell the ACCC what was actually going on. While consumers were complaining loudly about the lack of offers being made by suppliers, the public position of the producers was the exact opposite. Apparently offers were being made but we didn't know where they were and we would have loved to have met them and have a beer with them, but we couldn't find them. When Rod came out in September last year saying that consumers were right, finally we felt vindicated. So we're pleased to offer ACCC redemption if not unconditional forgiveness, and I'll go into that a bit later.

I also want to congratulate the ACCC for actually looking at the national gas effective in their work and also the AEMC in that matter for their recent work on the threat of the gas market, that is, as you should all know, in the long term interests of consumers. There are many on the supply side who seem to claim some divine right as to what that actually means and it tends to be quite different from what as consumers think it should be. So while I have offered redemption, I did not unconditional forgiveness. The ACCC is not entirely blameless in the history, although I think this happened before Rod's tenure. I well remember writing many submissions to the ACCC and arguing against the approval of mergers between the smaller Queensland CSM producers being acquired by the larger players because we believe it would substantially lessen competition. Unfortunately, we were not believed and, in fact, in one decision the ACCC ruled that competition would come from PNG gas, and we all know what happened to PNG gas. I spent two years of my life that I'll never get back negotiating to buy PNG gas.

The main problem with this report, after I've built you up Rod and, again, this is not your fault, is that it's really five years too late. If only the reforms the ACCC and now the AEMC recommends were started five years ago. The EUAA were highlighting these issues back then but we were ignored. In the words of a famous past Queenslander, and I am a Queenslander, "I'm here to help you, don't you worry about that". There is going to be plenty of gas for everyone, plenty of gas for LNG, plenty of gas for domestic consumers, so what are you worried about? As the ACCC concluded, and it uses a long hard view, we are not in some transitional disequilibrium in gas markets that will somehow magically correct itself in the near future. All the risk is put on consumers who did not have the means to manage that risk. It's going to be a long hard road before we get back to a competitive market. So let me pitch how I see the east coast gas market in 2016, and it's not a pretty sight.

The LNG developers have spent some $60 to $80 billion on projects that are now supplying a world that is awash with gas and are probably losing money if you fully allocate the costs they've invested. Asian equity participants in these LNG projects are reluctantly taking their take or pay obligations less any banking rights and are having troubling selling through use volume in their home markets, and they may be selling it at a discount to the price they're actually paying the LNG equity owners. They and their customers want to buy spot because spot's a hell of a lot cheaper. Domestic customers are struggling to get competitive offers, yes they are getting one or two and when they do they're at prices considerably above the prices being sold to the LNG off-takers, let alone the price those LNG off-takers are selling it for in their domestic markets in Asia. Domestic gas producers have no dollars for capex to develop fields for domestic customers and even if they did have the dollars for development, costs would probably mean sales prices that are above what domestic customers are able to pay and stay in business.

Blanket bans on exploration and development are stopping conventional gas as well as unconventional gas, perhaps because governments in a couple of states can't tell the difference or at least can't explain the difference between the two, to revisit the Daily Telegraph and the Herald Sun. There's very little that anyone can do about all of this unfortunately. Again, it's five years too late. Even if there was an overnight change in the moratoria of New South Wales and Victoria, I wonder whether the gas companies would actually have the dollars to invest in the capital required to develop the gas resources for domestic customers. So a lot of money has been spent to supply gas to those who don't want it, while those who want it cannot get it or, if they can, cannot afford it. Yes, we do have what the ACCC refers to as a triple whammy. In effect we've had 40 or 50 years of gas supply to domestic customers suddenly brought forward with the development of three concurrent LNG projects. So in the normal course of events, without LNG, you would have a great deal of development reserves so that as we go to harder to get, higher cost reserves that price would gradually increase to domestic customers. So they've got the $3 gas, they get the $4 gas, the $5 gas, the $6 gas, the $7, the $8 gas, but what's happened now is they've suddenly gone from the $3 gas to the $10 gas because any new gas developments for domestic customers have to have that cost structure, and I well understand what that cost structure is because all the earlier gas on the cost curve is going in a ship.

I have a different view then from the ACCC on the supply/demand balance for the next seven years. The gas power plant market will be squeezed by low-cost coal and renewables, commercial and industrial demand will be bashed by prices and restrictive terms and conditions. Just as well not a lot of capital will be available for exploration and development because the demand/supply balance in my view will be achieved by demand destruction, rather than the interplay of a competitive market. The ACCC and AEMO (Australian Energy Market Operator) correctly highlight the need for all paths to be competitive. So let me make a couple of comments. We support the push by the ACCC to re-regulate pipelines and the application for a lower threshold test for pipeline coverage. Unregulated monopoly pipelines are a barrier to competitive markets. Let me drawn an analogy, would the pipeliners be happy with a regulatory structure for their electricity supply with the owners of transmission and distribution setting their own prices and access principles? I doubt it. Large users dream of being able to monopoly price if they face international markets. Secondly, we support the review and breaking down of the Gippsland Basin Joint Venture marketing arrangements. Thirdly, we support the increased data transparency on both sides of the market. It's the price the supply side pays from a competitive market. Normally you have price discovery in a competitive market, we don't have a competitive market.

A couple of comments to conclude. All changes create winners and losers. Users recognise that times have changed and the old world price has gone, although I had a chuckle about a recent claim by gas suppliers that wholesale prices in Australia were relatively low. First they compared us with Asia, where they're the highest in the world, then they did not mention the current average price is heavily influenced by legacy contracts and conveniently forgot the cost of incremental supply, and then forgot about the Asian spot price. We're negotiating with both hands tied behind our backs still and so there's a lot of work to be done. While the short term is a bright future for competition lawyers and industry consultants, hopefully we can work our way through the issues and get a competitive market. So let me finish with a discussion starter. I mentioned earlier that a lot of money has been spent to supply gas to those who don't want it, while those who want it cannot get it and, if they can, they cannot afford it. Given the generally low oil price forecast for the next five years, there's not going to be much exploration and development. So even if the ACCC and AEMO were very successful in overcoming vested interests in making the market mechanisms more efficient, I still there will be few molecules to sell to domestic customers. They cannot mandate gas supply.

So where is a logical source for the domestic market, who has the gas that overseas LNG customers don't want but domestic customers do, who has the potential to get a better price for domestic customers than overseas customers for the next five years? I'm sure we'll know by the end.

LESLIE MARTIN: We're now going to move to Damian Dwyer on the supply side. Damian is the Director of Economics at the Australian Petroleum Production and Exploration Association (APPEA). His key responsibilities include a range of economic and trade issues with the upstream oil and gas industry, including climate change, energy policy and international trade issues. Damian began his career as an economist in the Australian public service and had positions within agencies including the Productivity Commission.

DAMIAN DWYER: My thanks to Leslie for the kind introduction, but also to Tony and the Grattan Institute for the invitation to participate in this evening's event. Of course, I very much welcome the opportunity to offer some thoughts on the ACCC's inquiry report from, as mentioned, an upstream oil and gas industry perspective.

So for those of you who don't know us, APPEA is the peak national body that represents companies engaged in petroleum exploration and production operations in Australia. Our members produce around 98% of Australia's oil and gas. I mention this for two reasons, one, because it's always important for you to understand who is that's speaking to you, and also because very importantly, as an industry association representing the industry in Australia, APPEA is not a party to any of the commercial transactions or other market conduct issues that were under consideration by the inquiry or of interest to the inquiry and will not be in the future. Now I say that because therefore, with the exception of an observation or two at the end of my comments, I've got little to say about those sorts of market conduct matters which were, of course, discussed in detail by the Commission itself with market participants through the course of the inquiry and, of course, are respected in aspects of the inquiry's final report. It also means I don't really plan, or at least not right now, to respond to some of the comments that Mark's made, some of which I agree with, some of which I fundamentally disagree with, and some of which don't really stand up to too much scrutiny, but many of them have already been dealt with by the inquiry.

What I am going to do rather is focus on some of the key policy issues in the report and on the way in which we should response, so on the way forward. How should we all respond to the recommendations made in the report and ensure that the inquiry leaves the gas market in a better situation than it found it? That's a key test from our perspective and I think it should be a key test from everybody's perspective. So a quick one, APPEA's media release in response to the final report which is up there, I encourage you to read it. It was headed "ACCC report confirms urgent need to remove regulatory restrictions on gas supply". Now this focus reflected two points, firstly, we've been saying that for a very, very long time and I guess I'll take the Pepsi Challenge with Mark about who's been talking about these sorts of things for the longest, and, secondly, it was heartening to see that the ACCC's findings and recommendations were generally consistent with this view. And, of course, that while the ACCC has in discussions that we've had with them, and I think this is appropriate, been keen to emphasise that their recommendations represent a cohesive package in their view of measures, and for the most part I think we would agree with that, it is to our way of thinking that no accident what the report's first two recommendations, which Rod mentioned in his address, were. I'm going to put them and read them because it's important that they stay up there and it's important that I reflect them exactly as they were in the report.

They were, one, governments should consider adopting regulatory regimes to manage the risks of individual gas supply projects on a case by case basis rather than using blanket moratoria. Governments should take into consideration the significant effects that the moratoria and other restrictions on gas development may have on gas users. Secondly, gas reservation policies should not be introduced given their likely detrimental effect on already uncertain supply. Now, I put those up and emphasise them because to our way of thinking it is from those key recommendations that the rest of the package of recommendations flow. If you do not allow the market to function properly to let supply respond to demand signals and to allow gas to flow as highest value use, the other actions that the ACCC has recommended that others have spoken about are really about treating symptoms and not the cause of the issues that people like Mark have been complaining about. You also impose significant costs on the entire economy.

In the case of a moratoria, for example, the Productivity Commission in I think are very good but very overlooked gas market research report that it conducted and reported on in March last year found that the moratoria in New South Wales and Victoria would, over the period they modelled out to 2031, reduce economic welfare across the entire economy between $164 million and $1.3 billion. Now I encourage you not to focus specifically on the numbers, that is not the right way to interpret the modelling, but it shows that there are losses across the community. And the losses associated with the reservation policy, which they also modelled, were estimated to be even larger with the Commission finding welfare reduced over that same period by between $2.2 billion and a staggering $24 million. Again, those losses fell across the community. The ACCC report therefore, to our way of looking at it, confirms the urgent need for policy and regulatory changes to enhance gas supply and highlights that the greatest risk to the market is regulatory failure. That's an important distinction from pure market failure – I hope there are a couple of economists in the room. It's not about the market itself not working properly; it's about the market not being allowed to work properly as a result of the regulatory restrictions, blanket moratoria and sovereign risk of almost every flavour that you can think of.

The report also confirms that removing unnecessary government restrictions on exploration and development would be the most effective way to boost supply, enhance competition, introduce new suppliers and, ultimately, put downward pressure on prices. Australia of course has ample gas resources to develop for both domestic and export markets if - and I think Rod mentioned this in his address - the industry is allowed to develop and is able to develop those resources. But in a time of unprecedented demand, government policies risk creating restrictions in the market that give rise to the sorts of experiences that Mark focused on in his address and for that to continue. The effects of an unnecessarily tight market are already being felt, you've heard Mark reflect on that, especially in an industry where gas is both a source of energy and a feed stock for manufacturing products, the plastics and chemicals industry being a classic example and the risk is most pronounced right here in Victoria. Almost 40% of the gas consumed by industry in Victoria is used as a feed stock, so it is that plastic and chemicals industry that I spoke about as well as others. Gas is also the highest domestic use, residential use by households, 70% of Victorian households use gas.

So let me deal quickly with a couple of issues before finishing up and handing over to the other speakers. Rod reflected on this, the ACCC was asked to conduct this review because it has the power to obtain confidential commercial information. Using this power and, I'm told, using it quite liberally, which is appropriate, the Commission has amassed the most detailed and complete data on the market. With this data it's been able to put to the test all the claims made around the market by both users and producers. Now, we had the comments that Rod's made, we had the comment that Mark's made, but an important point was the ACCC found no evidence of misuse of market power and other breaches of competition law, so nothing for them to act upon. While market conditions were tightened in 2012 to 2014, and that was acknowledged and you've heard Mark reflect on this, it is the case that a range of gas supply offers were made and executed during that period and, as the report finds, the situation is now the case that more gas suppliers are available. The Commission has also recommended measures to provide more public information on the market. APPEA, from our perspective, certainly understands the desire for greater market transparency. We have been, we are and we will continue to consider those recommendations on their merits and look forward to working with governments and customers on way to improve market transparency.

In conclusion, the industry welcomes the Commission's findings and trusts that the public debate can now move on from some of the more discredited arguments that we've seen and focus on the real issue. That's my earlier analogy to the cause, not just to the symptoms. In particular, we're looking forward to the COAG Energy Council to make regulatory reform an urgent matter of priority. This is probably the key message from us: governments must remove regulatory barriers to bring more supply and more suppliers into the market. And with that I thank you. I look forward to the panel discussion and to the Q&A. Thank you.

LESLIE MARTIN: Thank you Damian. Now we're going to move to our last panellist, Nevenka Codevelle, who is speaking on behalf of APA group; that is now looking at the side of who owns and operates the pipelines. Nevenka is a senior executive, she's a Company Secretary and General Counsel in APA Group, she's a senior executive with over 20 years' experience as a corporate commercial and competition lawyer, particularly in infrastructure industries. She's currently responsible for the legal company secretariat risk and compliant functions at APA Group and is a member of the company's core management team, involved in all major transactions and growth initiatives that led to the company's growth from an ASX250 to an ASX30 company in less than ten years. She also spent over three years as a senior policy adviser to the National Competition Council.

NEVENKA CODEVELLE: Thank you for the opportunity to participate this evening, it is a really important debate to be had and Rod and I have had discussions about the need to continue to engage on some of the important findings and recommendations that came out of the report, so thank you for the opportunity. I'll start with one thing that we can absolutely all agree on, and that is the need for gas supply and more supply. That I think all of the panel would absolutely agree with and it was good news to have the finding from the inquiry that there is sufficient gas forecast to be produced to satisfy both LNG and domestic demand to 2025. That though is predicated on forecast production occurring and one would assume on its ability to get to the market, and that's where the pipeline industry comes into play.

So pipeline infrastructure, as the report noted, is absolute critical to making all of this happen, to getting more gas supply into the market and ensuring there is a diversity of supply. The pipeline industry's success is dependent upon more supplying coming into the market and more customers having access to gas. In that regard, incentives are absolutely aligned to ensure that this market grows. To this end, the pipeline industry has a demonstrated record of investing and innovating to give customers the services they need to ensure gas projects proceed. Over the last decade and with the current regulatory regime, APA has spent over $12 billion on infrastructure, systems and technology to provide more pipeline capacity and flexible services to meet customer needs. APA invested in developing the east coast gas grid which links all major sources of gas to all major demand centres on the east coast, making basin and non-basin competition a reality. Around $40 million was spent on IT and asset management systems alone to enable the provision of seamless one-stop-shop services across the entire east coast grid. All of this investment and innovation occurred without a cent of government financial support.

When it comes to gas prices there's no doubt the LNG markets have exposed domestic customers to LNG export pricing and increases in gas prices have not been the result of an increase in pipeline transmission charges. Transmission charges make up between 5% to 10% of the delivered price of gas for retail customers. The 2015 gas market report published by the Department of Industry indicates the transmission tariffs for the industry as a whole have not increased in real terms since 2002, notwithstanding rising gas prices. So we're all in agreement that need to develop more reserves. Gas reserves need infrastructure development and that's where the pipeline industry has and will continue to deliver. It's therefore disappointing that the ACCC report tends to characterise the pipeline industry as part of the problem, rather than a critical part of the solution. The ACCC points to a number of incremental pipeline projects as evidence of broader concerns regarding pricing in the industry. The allegation is a serious one and one that APA rejects. And I am the lawyer on the panel with my economist friends and, I must say, as a lawyer I take my evidence very, very serious and I take claims of this nature very seriously. To put the claim in perspective, the half-a-dozen or so APA projects or the projects we understand to be APA projects that were reliant on the ACCC, on a net present value basis make up less than 1.25% of APA's enterprise value.

In relation to interruptible services, also considered to be highly priced by the Commission, these services account for less than 0.5% of APA's total revenues. No evidence of monopoly pricing was noted in respect of the remainder of APA's business, with the ACCC acknowledging the existence of competition in the market for pipeline development, this being the basis on which the bulk of our revenues are derived. The Commission did mention the Southwest Queensland Pipeline, that pipeline, and I won't go into all of the history but was an outworking competitive processes. There were a number of expansions to capacity and on each occasion the ships had alternatives in terms of the development of those capacity expansions. The second point, almost all of APA's projects were subject to competitive pressures, either from another pipeline or from customers. The tariffs and returns there for outworking's of those competitive processes and reflected market conditions at the time. So coming back to the Southwest Queensland Pipeline, the last expansion was committed to at the height of the GFC and, again, the tariffs that were outworking, so those competitive processes reflected the financing costs and the market conditions at that time. Our customers are large, well-resourced companies well able to look after their own interests. Believe me, when you actually are on the other side of the negotiating table with them, they are not pushovers by any stretch of the imagination.

Third, the projects selected were incremental projects that add value to existing pipeline assets, such as bidirectional or compression projects. It's potentially misleading to look at rates of return on incremental projects on a standalone basis without any reference to the costs or returns attributable to the underlying assets. Although the ACCC's benchmark on what the appropriate returns should be is questionable, there is certainly much room for debate around appropriate metrics and methodology. The lawyers can argue until the cows come home on asset base valuations, cost allocation methodologies and appropriate rate of return hurdles to compensate the project risk. Unfortunately though, the Commission's process did not provide an opportunity for industry to comment on a draft report so much of the debate that should have happened didn't happen. So it's on the basis of this evidence that the Commission recommends a change to the test, presumably a lower threshold, for the regulation of pipelines. The change to the test is a fundamental shift in the regulatory regime and one we say is unnecessary. Again, speaking as the lawyer, it was notable that the chapter which discussed the test didn't actually refer to tribunal and court decisions which expressly apply to the current published criteria to the integrated businesses.

So in our view, the test is appropriate and changing it would introduce uncertainty and increase regulatory risk. Increased regulation comes at a cost, that's well-accepted. The cost is both direct in compliance and administration and so forth, but most significantly the cost of distorting incentives for investing and innovating critical infrastructure thereby limiting market growth. In the case of coal, for example, the infrastructure bought in the resources boom began in 2004 and are estimated to have cost the Australian economy in excess of $10 billion in lost coal export revenue. The Productivity Commission has warned that regulators should be circumspect in their attempts to remove monopoly rents perceived to attach to successful infrastructure projects, noting the potential loss of major benefits to the community where infrastructure projects are foregone or delayed. Maintaining the 15 year greenfields regulatory holiday is not, as the ACCC suggests, an answer to addressing the risk of undermining the investment incentives. The time delayed processes simply don't work when developing greenfields projects, which are invariably part of competitive processes. The greenfields holiday has not, as far as the APA is aware, ever been relied on prior to project commitment.

Finally, the gas market is a substantial way through the biggest transition it is ever likely to see. The market needs time to transition and adjust, which it is doing, and changing fundamental regulatory settings at this time simply is not the answer to increasing gas supply or diversity. The industry is working with the AEMC as part of its framework review and an increasing liquidity and assets to capacity. Improved capacity trading platforms, information transparency and, most recently, a proposal for capacity options with a $0 reserve for unutilised capacity are all on the cards. It is by enhancing the market mechanisms, such as the ones I've just mentioned, rather than the prospect of heavy-handed regulation that gas market product will be facilitated. Thank you.

LESLIE MARTIN: So now we're going to take some of the questions that we received before the session and I will use my position as moderator to ask one of my questions to kick that off. This is mainly for Rod, but I'll be also curious for the rest, the broad question is do you expect that we'll see a repeat of this recent history of high gas prices? I guess where I'm coming from that is when you talk about the triple whammy I wonder if there is any analysis done as to the relative contribution of the three different component, because when I think of it I think of LNG, that's here to stay, the moratorium, well that's something that may well be repealed, oil prices are going to be fluctuating, and so the relative role of these three in contributing to this overall whammy. Help us get a sense of is this something that's going to happen again or is this a one-time fluke and we might be clear sailing in the future?

ROD SIMS: The price we don't see coming down anytime soon and, as Mark said, it has many reasons to go up. The supply outlook remains uncertain and it's not clear where that extra gas is going to come from. The lack of competition in the southern market, there's no particular reason at this stage why that's going to change very quickly. So I'm not sure about another kick up, but the forces that are there will stay for some time. As Mark said, you've got an increasing cost curve, obviously all supply curves go up, and so as more gas is produced you'll just reinforce the higher cost structure. I don't think you'll repeat these circumstances because I don't think you'll ever seen three $20 billion projects going ahead, no matter what happens to the oil price, so that won't happen again. But the other factors need to change, unless you're going to have a change in the circumstances.

I mean, it's impossible to allocate between the three – well, impossible, you can put numbers around anything I guess, but clearly we can quantify the amount of gas that is no longer available in the domestic market. Certainly gas coming out of Moomba used to go south into the Victoria and New South Wales markets, that now goes north so you can see the diversion of gas quite clearly. But overlaying that you've had projects that were meant to go ahead but didn't go ahead that would have boosted that supply. So how you balance that out, it's very difficult to do and then, of course, you've got the cutback in exploration, which is quite visible. You can quantify that too because of the lower oil price and the cash shortages, but how it all balances out as to what's contributing or not I don't know. It's one hell of a triple whammy. All those factors have had a significant role in creating the supply uncertainty and the lack of a competitive market for the supply of gas. I'm not answering your question very well, but each of them was significant. For want of a better number, I'll allocate them a third each.

LESLIE MARTIN: Does anyone else want to answer that or shall I move on?

DAMIAN DWYER: The only perspective I guess I'd add to that is a range of factors obviously were in play during that period and a range of different factors are in play now. So the questions becomes then what are those factors and how do we control them, what can we do? So international oil prices, the operation of the international oil market, the associated flow-on to the gas market; they're a range of factors that have brought that about most of which are outside of the purview of Australia. What can we control? What can we do something about? It's the part of the triple whammy that goes to the regulatory arrangements that exist in Australia. We can do something about that part of the equation and, from our perspective, that's where some useful time can be spent. Now we can argue about what are the right and wrong parts of that approach, but for us that's the bit you can control.

LESLIE MARTIN: A very quick question for Damian, at one point you made the comment that the ACCC report had seen that there was no misuse of market power. What would you need to have seen to find misuse of market power?

MARK GRENNING: I think the test is very clear, did the ACCC find any breaches of the provisions of the Competition and Consumer Act?

ROD SIMS: Can I jump in there? That's what I went and got the report, it's been a while since I've looked at it, but we have two statements of future work. One is that we will look at the joint marketing arrangements. That potentially could be a branch of Part 4 of the competition provisions. Not misuse of market power, but agreement that substantially lessens competition. I remembered that one, the one I just wanted to make absolutely sure about our words. We'll consider whether the availability and pricing of capacity on some particular regional pipelines raises any concerns as a breach of misuse of market power. So we did raise concerns about potential misuse of market power.

MARK GRENNING: I won't respond to the first one, but the second one yes, my perspective, upstream. So the pipeline question belongs to others in this debate.

DAMIAN DWYER: Just one other point, in just about all markets the question of whether or not there's enough competition and what affect that has on the market is usually quite different from whether there's been a breach of Part 4 of our competition laws. I mean, those laws are having the effect of substantially lessening competition, finding people in smoke-filled rooms having cartels. Most of the time you see a lack of competition causing higher prices it's not a breach of the Act, that's very much the exception. So it's not a surprising finding and, of course, it's never been against the law and never will be against the law to use your market power. If you've got market power I'd use it. If I had market power, if anybody gave me market power I would use it and if I was on the board of a company that had market company and my Chief Executive didn't use it, I'd fire him or her as being a dill. So of course people are going to use it.

MARK GRENNING: That's a very important point. The issue of concern to users is not some legal nicety about whether or not there's been a breach of the Act. What's of interest to consumers is whether or not the market's competitive and the market's clearly not competitive. It's a second order issue to us or a third order issue whether or not there's a legal issue involved.

ROD SIMS: Correct.

MARK GRENNING: It's whether there are markets, and there are no markets.

LESLIE MARTIN: This is almost more of a comment than a question on this, I feel we've been talking a little bit about more supply but then sometimes saying more suppliers. When we talk specifically about the moratoria, the moratoria is on new projects and so there's this question of are you going to get more supply out of that? It's not as clear to me that by removing the moratoria you're going to get more suppliers entering the market, but maybe you have something that you could say about the barriers to entry in this market and to what extent you'd get new firms coming in because if you have very few firms, those firms might be exercising market power by withholding output in order to drive up prices, right?

ROD SIMS: Understood and, again, whenever you talk about projects affected by the moratoria or the regulatory restrictions, governments have to weigh up their environmental concerns and we don't have the qualifications to comment on that. But clearly one can easily nominate three quite large projects that would have been there, I think, by three different producers that aren't there now and yes, two of those producers are well-known companies you'd think in the market, but they don't have much supply left for the Victoria market. So if those three projects had gone ahead you'd have three quite large suppliers to the market in a sense competing with the dominant supplier, which is the Gippsland Basin Joint Venture. So it certainly would have given us more supply and more suppliers. Back in the good old days of users they would ask for gas and get four, five or six, maybe four or five –

DAMIAN DWYER: Maybe not that many, but probably two or there.

ROD SIMS: Well, the numbers we had were four or five but irrespective, if you'd had another three on top of the Gippsland Basin Joint Venture, that's four and at the moment you don't have that. So it doesn't mean new players, I mean, even Origin or AGL having gas they don't have now, because they don't actually have that much gas. Even Santos, yes, it's got gas but it's all going north. So clearly one of the projects they were going to develop unambiguously was going to flow south, that's all the plans were to flow that gas south. So they would have been supplying in the market, whereas at the moment they're not now. So that's what we mean.

LESLIE MARTIN: One of the questions that was sent in is what do you think are the risks and benefits of the AEMC's proposed changes to the Victorian declared wholesale gas market for Victoria and for east coast gas in general?

DAMIAN DWYER: It's not a direct comment on the Victorian market, but I guess the AEMC, another review that's underway, we spoke before about review after review and the AEMC's review is a very important one because it's about the forward market regulatory arrangements across much of the gas market on the east coast, and obviously upstream is where our interest lies. The recommendations are due very soon, they'll be considered by COAG, there'll be a long, I suspect, consultation process around the implementation of those recommendations and we would see, without getting into the detail, an assessment of the costs and benefits of those recommendations, new market design, new regulatory institutional arrangements, those sorts of things, being a key feature of the implementation going forward. So you put a new market model in place, for example the short term trading market's been with us for a little while now, there are proposals in the AEMC's report for a re-design in essence of those markets and part of the implementation of that, if governments move forward with that implementation, should be a pretty clear cost benefit of that. That's an important part, we would have thought, of any regulatory reform process.

ROD SIMS: Leslie, just quickly, in our study we were complements with the AEMC not substitutes. So they had their territory and we had ours, we talked to each other quite a lot, but their focus was not ours. As Damian says, it was short term market design and yes, it went to the Victoria market, Nevenka may or may not have a comment on it, but it's not something we looked at or had the knowledge to have a view.

NEVENKA CODEVELLE: Just picking that point up, so the AEMC framework review is a very important review and it is focused on enhancing the operation of the market, and I touched on some of the measures when I spoke. A very good aspect of that review is the industry consultation. So industry has been working with the AEMC and a lot of the proposals that have been put together have been developed jointly with industry, so I see that as a very positive step in terms of enhancing liquidity in the market.

MARK GRENNING: So on that basis, I look forward to the industry supporting the quick implementation of what the AEMC is saying, given that you're jointly developed them with them, because I think it's wonderful the AEMC is actually listening to consumers for once, as is the ACCC, in terms of the national gas law. So we're very supportive of what the AEMC is doing. Our only concern really is that those interests who are not in favour of doing that will seek to delay it.

LESLIE MARTIN: There's one question that's directly written to Mark Grenning, do you believe the Australian Government will move towards a ban on fracking?

MARK GRENNING: I've got no view on that I'm afraid.

LESLIE MARTIN: Instead of the likelihood of the ban, do you have any comments on the implications for instance?

MARK GRENNING: I'm not a scientific expert, but my understanding is that a number of scientific reviews have been done both in Australia and overseas which suggest that it's a perfectly acceptable technique with the appropriate safeguards. Perhaps Damian, you know more about than I do?

DAMIAN DWYER: Yes, thanks Mark. That's pretty much what's been found, but probably the key point to make of course with the Australian Government is the way the regulatory policy regime works in Australia is that State Governments are responsible for regulation of onshore gas developments and the Commonwealth Government, the Australian Government, is responsible for the offshore. So that makes the likelihood of them banning an activity that doesn't take place offshore unlikely. I think it's unlikely anyway, but that makes it clear.

MARK GRENNING: I'll make a general observation about those people who have an interest in stopping gas exploration because of fracking. They seem to have a selective view of the acceptability of science across a number of issues that they collectively go for.

LESLIE MARTIN: Ouch!

ROD SIMS: You felt it too.

LESLIE MARTIN: How does the panel see the market for biogas as a replacement for natural gas evolving?

DAMIAN DWYER: It'll depend on the market policy arrangements I would have thought. Does biogas find a role as a replacement for natural gas, is there demand for it, can it be produced cost effectively, can it compete with the uses that gas is put to right now? If it can do all that then it may well find a role.

MARK GRENNING: The standard debate around biofuels and biogas is whether or not they're net carbon efficient because of the carbon involved in using them and the land that they use up that could be used for other food sources. I understand from an article I read in the New York Times this week that there is the first facility in the United States that's actually been shown by an independent review to be carbon neutral in biofuels, but I think there's a very long debate to go before that is resolved.

LESLIE MARTIN: If we can move to the audience questions, what I propose is that we take questions in sets of two and we'll pass them to the panel and see who'd like to answer them.

AUDIENCE: Very valid points, I guess from my experience, having worked for some of the largest utilities for a number of years, I think there are a number of valid points raised tonight and they were really around the market clearly needs more supply. I do agree that customers and particularly the buyers have become far more sophisticated nowadays, probably the most gruelling negotiations you'll ever be involved in. You'd certainly learn to be a good negotiator. But that presents a number of new risks for producers and also suppliers and retailers to manage. So I guess that also needs to be taken into account, certainly if you've been involved in that buying and selling process. I think also from my experience on the electricity side one of the best things that I've seen is the second tier retailers. There needs to be a distinction in this discussion tonight around not only the supply side, but also the retailing side, because the suppliers are you defining them as producers or are we defining them as retailers? In an electricity perspective they were probably the biggest game-changer in electricity.

My question would be around the transparency, could someone give comment with respect to the transparency and what transparency would benefit the market?

AUDIENCE: My question is in two parts. The first part is, is gas a fossil fuel? The second part is, how does the gas industry propose to get around Australia being a signatory to carbon emission reduction agreements?

ROD SIMS: I'll deal with the transparency quickly. We recommended a number of things, but just quickly we recommended more transparency around pipeline costs. Certainly we saw instances of fully depreciated pipelines that had cornerstone customers, foundation customers, and when those foundation contracts rolled off the price went up. I guess that's what you would do, but just getting a bit of transparency around costs we think would help negotiations between the pipelines and the shippers. More transparency around resources and reserves, just so people know what's available, what's there, what's contracted, what's not, again, would help the market, and more transparency around price. So we recommended that publication of the net back price so people would have that as a stake in the ground, but also recommended the AEMC just have a look at whether you want to record actual prices. And that's going to depend on whether you can get enough thickness in that market to do that properly, so working with particularly the users to see whether that would be something useful. There were a range of other things, but the market has gone from being a market that worked well as a bilateral market because there were enough competitors and the market worked to one where the market does need to function in a more effective way and there clearly ism, in our view, a market failure with a lack of information. A small number of players have got the information and the users and others don't have much.

MARK GRENNING: There's certainly an information asymmetry between buyers and sellers in the gas market and that's why we support the greater transparency. If you had a properly functioning market you'd have price transparency and discovery through the negotiation process, but you don't have a competitive negotiation process. I'd have one comment on Rod's comment about the old bilateral markets. I'm old enough to remember those markets and be evolved in those and while they worked well, there was no sense of transparency around there. Those of you old enough to know, like me, the legal battles that used to be fought out by the suppliers in various supreme courts around price review clauses and the disclosure of information that enabled buyers to find information and price review clauses suggests that the level of transparency was not high then either.

DAMIAN DWYER: Two comments if I could on the transparency side of things. Just on that, I guess it is important to recognise the history of the gas market which is one around long term bilateral contracts and I will admit, I will bow to Mark's knowledge in that space because I haven't been involved in any of them. But certainly my understanding is that some of the confidentiality clauses around those bilateral contracts came from both sides. It hasn't always been the suppliers wanting that to happen.

LESLIE MARTIN: So you're recommending a history against transparency?

DAMIAN DWYER: No, the history is terms of maintaining contract clauses and price discovery clauses confidential sits on both sides historically. That's what I'm saying, it's not just suppliers. That's not really my point, my point is moving forward from that market to a market that's more open and transparent. It's important to remember that we have been on a journey for the last ten years or more around that, so we've had short term trading markets introduced, we've had gas statement of opportunities developed, we've has the gas bulletin board implemented. We've had a whole range of things happen so the fact that the market's completely opaque and no-one knows what's going on, that's not the case. The case is we have been moving towards more information. So the ACCC and AEMC, without any shadow of a doubt, will make a range of recommendation is this space and, as I mentioned in my comments, we'll work through those recommendations in a timely manner. Anything that involves the COAG Energy Council doesn't move rapidly despite the best wishes of everybody, depending on your view of the world, but we will be involved in those processes.

The key thing for us then will be, one, ensuring that the extra transparency and extra information introduced into the market is useful, isn't just information for the sake of it because you can be misinformed in those spaces, and that it's done in a cost effective way of all that's involved. If we can tick those sorts of boxes then we can move forward in that space, without any question.

LESLIE MARTIN: Just to follow on the transparency I'm wondering, when you went through the ACCC process for this report, was there anything that surprised you when you got to see all of these offers? You said there are thousands and thousands of documents that were revealed, was it all just in line with your priors or was there some sort of information where you thought, "Wow, I was not anticipating that at all"?

ROD SIMS: Oh yes, quite a lot but given that it's pretty well confidential.

LESLIE MARTIN: The individual specifics right, but when you were writing the report was there anything that you wrote that you were not expecting that you would be writing, that you thought you were going to go in and write a report that said X but instead no, you ended up writing Y because you learned something that really changed your mind?

ROD SIMS: I guess we were surprised about the lack of offers that were made. We hadn't quite realised it would be the one zero that it turned out to be, so we're extremely confident of that. Whatever contracts were done during that period were just between the suppliers, there certainly were buyers who were used to getting, we would have said, three to five offers and then got none and would then go chase the offers and not get a response. So that was surprising, I hadn't thought people who aimed to cultivate long term relationships would do that, but I'm, off the top of my head, struggling beyond that. There probably is, but I'm not doing a very good job of remembering them. That was the one that surprised me the most. I was sort of taken aback by how the producers dealt with their consumers.

LESLIE MARTIN: I cut you off, you were going to say something about carbon?

ROD SIMS: Just to say that this debate changes around a lot and there was a time when gas was going to be a transition fuel on whatever carbon journey one wants to go on but, as Mark is saying, the gas generation has been crunched. There's no doubt part of the reason why the supply works is that people aren't using much gas at all for gas-fired power generation, that's pretty well been wiped, so you don't have that anymore.

DAMIAN DWYER: Except in South Australia.

ROD SIMS: Yes, that's right.

DAMIAN DWYER: You need to keep the lights on.

ROD SIMS: But then you've got therefore a market that's basically coal and renewables and, of course, that's a tricky situation since most of the fast-start power generation is gas. There are different views about what renewables can do, but the investment that allows them to backup each other is a stunning amount of money which is not going to happen for some time, just as a matter of physics it's not going to be there. So gas generation backing them, admittedly if it's fast-start peakers they don't need much gas and they're still in the market but, nonetheless, you've got a market that had a particular way of approaching the transition in the electricity sector and that's been severely interrupted. We've got more coal than we would have had without this interruption to the gas market.

AUDIENCE: The question had two parts, is it a fossil fuel?

ROD SIMS: Of course it is, yes.

AUDIENCE: And our international agreement to reduce carbon?

ROD SIMS: But that's the point, part of reducing carbon was decreasing coal and moving to other sources, one of which is gas.

AUDIENCE: It is stark when you read the report, and I'm focusing on the pipeline regulation recommendations, that there is a conclusion that a particular test as the gateway to be subject to economic relation is profit. Indeed, the recommendations acknowledge that there is some detail that's required even to implement that test and recommends that the COAG Energy Council and AEMC be involve in that. However, it accepts as a fait accompli a particular test as the gateway to regulation. In circumstances where there is of course a range of potential tests, including the existing one, that could well warrant some careful analysis which, given that the process in the gas inquiry did not permit a draft report and the commenting on the draft report, we're in a process scenario where are we dealing with a fait accompli and, if so, why? And why are we not allowing ourselves to ask the question as to whether the bar is set too low in a test built around market power and a contribution to efficiency as distinct, for example, as you see in the law that was passed earlier this year in Victoria in respect of the Port of Melbourne. And I'm not advocating that this is the best regime, but it's an interesting example because it has a substantial market power test but requires that there have been an exercise of that power with the effect of causing material detriment to the long term interest of Victoria consumers, which is a substantially different test for economic regulation than the relatively low bar that is set by the Commission in its recommendations.

So my question is why are we not debating whether that is the right test and why do we have to assume, based upon the analysis that we've seen, that that's a fait accompli and that's the world that we should live in?

AUDIENCE: A question on the pipeline regulation issue, and it's probably a bit of a simpler one, it's really directed to the users and the producers. The question is do you guys really think that having a pipeline industry more subject to regulation is a good thing? And to give you the background, from what I've observed there are, as has been pointed out, big hairy people negotiating pipeline shipping contracts, they're capable of building transmission pipelines of their own and indeed they did for the LNG industry in Queensland. You've also got pipelines in WA which effectively are regulated but you've seen shippers, including users, prepared to contract above the regulated price and the reason that I've heard them give is because it allows more flexibility, it allows a greater degree of fairness around who needs more capacity, who's going to pay for that capacity, how quickly can that decision be made and implemented. Certainly I think also in Queensland there has been a lot of response from the pipeline industry encouraged by the shippers to quickly do what was necessary to increase capacity, make pipelines bidirectional. So, to me, it seems like that's actually worked quite well in the interests of users of those pipelines.

So do you think that having to deal with people who are behaving like some of the regulated networks in electricity is really a step forward?

ROD SIMS: Our report goes to COAG so there's not been a ruling. In a sense, the decision makers are COAG, they can start whatever process they want, we haven't arrived at a – well, we've arrived at a conclusion in our minds, but we're not the decision makers here. So the premise behind the question, in a sense, to me is that we're the decisions makers, well we're not, there's another process to go and I'm sure the decision makers are getting lobbied left, right and centre. Our point is that if you want the possibility of regulation the current test is just not fit for purpose. In my admittedly not so humble view, it makes no sense to ask about upstream or downstream competition when you don't have a vertically integrated asset. The question is, is there market power in the pipeline? I take the point that there's certainly a legitimate debate around how high you want the bar and personally am totally open to that debate, but directionally having it based around the market power of the pipeline versus around competition upstream or downstream, which is just not relevant. We see this time and time again that you can have tremendous market power on the pipeline and put aside whether Nevenka thinks there's market power or not, but if you just assume there is, and there may not be, but if you assume there's market power then the pipeline would have the ability to put up the price. That can have an enormous effect on economic efficiency, but no effect on competition, zero, because everybody is paying the price of the higher pipeline. So it's just the wrong test, it's just demonstrably the wrong test.

So the question is do you want the option of regulating the pipelines or not? If you want to rule it out forever then fine, don't regulate them. But if you want a test that can at least allay to us the question, then I think you need to change the test and you're raising a legitimate question about in the way we've framed it have we set the bar high enough? That's a perfectly legitimate question. I accept had we had time to put out a draft report, we didn't, we work to a timetable, a draft report would have helped us better engage on that question. So I accept the height of the bar is a question, the direction of change to market power from competition. Competition is just not relevant to the market.

NEVENKA CODEVELLE: Just a comment on the test, I challenge the proposition that it isn't fit for purpose in non-vertically integrated industries and there are a number of cases where the coverage criteria or the declaration criteria were applied to non-vertically integrated industries, including airports for example and also gas pipelines. So there are a number of gas pipeline cases where applications for revocation of coverage were sought and were knocked back on the basis that the coverage criteria were satisfied. So I don't accept that pipelines in and of themselves by virtue of not being vertically integrated can't meet that test.

The second point I'd make is the test is all about will the pie get bigger? There's no point regulating if the pie won't get bigger. So everyone talks about efficiency, courts have interpreted the requirement around the competition criteria as being a test around will the pie get bigger? So we can have many legal debates around how that criteria is framed. From our perspective it doesn't need to be changed, but what's more important is that there is an opportunity for that debate to happen. And I note that many of the Commission's other recommendations were for further consultation but, as was pointed out, this particular recommendation was presented as a fait accompli with a consultation occurring on factors to be taken into account. So I accept that ACCC is not the decision maker, but it just stood out as somewhat different in character to some of the other recommendations.

LESLIE MARTIN: Do either of you have any concluding words, I'm going to have each person address the one point they'd like to address and then we'll have to close?

DAMIAN DWYER: A very quick one then. I don't have specific comments on the ACCC's recommendations in this space. It's a broader comment that goes to the market works best when all parts of the market are working effectively. So that includes the upstream, that includes the pipelines, that also includes the retailers, to the question that was asked before, and the distribution network. So from our perspective, I certainly don't want to go back and repeat things, but it was a shame in some respects that the terms of reference for the inquiry itself weren't broader to take into account those sorts of issues. But, as I said, I'm with Mark in some respects in that we've reached the time now where we need to move on, take some action.

MARK GRENNING: I'm in furious agreement, it may surprise you, with Damian that all parts of the supply chain have to be competitive for the result that we're looking for, that all parts of the supply chain have enough incentive to invest as they need to and get the return that they need to, and that we have a competitive market so that the gas goes to the best use which gives the best return to the economy. I didn't mention in my talk, but the EUAA does not support reservation, does not support a national interest test; it supports the use of resources in the most efficient way. So we look forward to consideration of the report by COAG, we look forward to the consideration of the AMEC moves to improve the competitiveness of various parts of the market, and it's great to congratulate the ACCC on a job well done.

LESLIE MARTIN: Would you stand by that even if the best use was LNG in that all natural gas should be headed towards LNG rather than, say, a mix of domestic, industrial and LNG uses?

MARK GRENNING: Yes. If the market was competitive, and we can have a debate about what a competitive market means over a glass of red, I perhaps have a different view of a competitive market than some other sectors of the industry. But if that's what a competitive market says then I see no reason why gas goes to the highest value use.

ROD SIMS: My final comment would be apropos surprises, I guess I hadn't really realised how many manufacturing plants we have in Australia that use gas. I was very surprised at how many there were, how big they were, how many people they employed and they're producing paper, they're producing plastics, they're producing fertilisers, glass, a whole range of things that are longer than I can remember. So if you think we don't have much manufacturing plant in Australia, we've got a hell of a lot and gas is pretty important to a lot of it. So it's one thing, as Mark said, for those plants to disappear because they're no longer the highest value use. We all understand industries come and go as they become economic and they're no longer economic, but the worry I have is we might lose some of those industries because we actually don't have a properly functioning gas market, and that I think would be a bit of a tragedy.

NEVENKA CODEVELLE: Just to reiterate those comments, we need more gas supply, we need more gas suppliers, and we are all for a liquid, sustainable gas market. So it comes down to a question of what measures are going to achieve that. We don't see heavy-handed regulation as an answer, but the sort of measures we're engaging with the AEMC on, increased transparency, trading platforms etc., are where we think we'll get the biggest bang for our buck.

LESLIE MARTIN: Thank you all for coming tonight, thank you to the Melbourne Energy Institute for hosting this event along with the Grattan Institute. Have a lovely rest of your evening. END.