



Centre for Mining & Energy

Upstream Gas Regulation & Competition Reform

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1. Introduction

It is a pleasure being here today to talk to you about the ACCC's role in deregulating one of the most fundamental industries upon which the Australian community relies - that is, the gas industry. Certainly, the importance of having a reliable and constant supply of this essential commodity has been highlighted in the past weeks by the disturbing circumstances which have plagued Victoria since the Longford disaster.

2. The ACCC's Role in Deregulation

Firstly, I would like to start off by saying that economic reform is about changing the way in which firms do business in order to improve resource usage. The traditional view of public utilities such as gas was that they were best supplied by a single operator, and that it was in the interests of the community that they should be owned and operated by government.

The Hilmer report suggested that whilst some assets in a market will be naturally monopolistic, those businesses downstream and upstream of the asset can operate in competitive environments, where there is a regime which enables effective access to the services offered by the natural monopolist.

As a result of the COAG review, the Commission has been given a significant regulatory role in relation to communications, energy and transport. Whilst today's presentation focuses on gas, it is true that the stories in respect of the benefits of deregulation of each sector are the same.

In relation to gas, economic modelling has provided an estimate of the potential benefits that are available from gas industry development. Studies carried out by ABARE for the Industry Commission estimate that the economic returns from new gas pipeline interconnections alone could total \$1 billion (in net present value terms) Australia-wide over 35 years.¹ On the other hand, the Australian Gas Association (AGA) estimates that continued restrictions on interstate trade in gas could result in additional cost to Australian consumers of between \$1.5 billion and \$4 billion in net present value terms by the year 2029-30.² Based on the experience on other countries such as the US and Canada, which undertook significant gas reforms that led to a more competitive market environment, Australian consumers can expect to reap significant benefits from gas industry reform. At the same time, there has been no indication of a loss of security of supply or service reliability.

Thus, the successful introduction of competitive reforms to the gas industry is a key to providing incentives to participants at all functional operating levels to improve the efficiency of their production, resource allocation and investment decisions, and to minimise costs. These benefits are not limited to the gas industry, as gas is an important input into many Australian industries, influencing their ability to compete both domestically and internationally. Certainly, this has been significantly highlighted in the past weeks by the events in Victoria. Benefits are likely to be distributed broadly throughout the economy, through lower input costs to Australian industry,

¹ Industry Commission, *Australian Gas Industry and Markets Study*, AGPS Canberra 1995, p.231.

² AGA, *Gas Supply and Demand Study*, 1992.

lower prices to final customers, and more efficient use of resources. Hence, regulatory and public policy reform of the gas market is vital to Australia's ability to capitalise upon growing international and domestic demand, and to capture its natural advantage as a low cost energy supplier.

Ensuring that competition can work to yield welfare enhancing results gives rise to two regulatory issues:

i) Access

There is a need to ensure that businesses which operate in upstream or downstream markets are able to access the services offered by the natural monopoly asset. Particular concerns may arise if a monopolist has a downstream arm to its business as it may be in a position to impede competition in the downstream market by denying competitors access to its services, or by selling its services at a favourable price to its downstream arm. Such behaviour could seriously limit the effectiveness of competition in the upstream or downstream markets.

ii) Access Prices

Monopoly status confers significant market power on an asset owner, enabling it to earn monopoly rents by charging prices in excess of competitive levels. Further, a monopolist might restrict supply to increase prices and this could seriously retard growth in downstream industries. To prevent inefficient outcomes, the challenge for the regulator is to ensure that users upstream and downstream of the monopolist are charged prices which reflects the true costs of providing the service. Otherwise, monopoly rents will be passed on to end users and the benefits of reforms in the natural gas industry will not be realised.

Enter Part IIIA of the TPA, which has been designed to facilitate a smoother transition from regulation to deregulation by addressing issues such as imbalances in power between parties negotiating access arrangements.

Part IIIA has been designed to pursue two main objectives. The primary objective is an economic one. It aims to improve economic efficiency by introducing competitive forces into certain essential facilities which have been monopolised by one, or a very small number, of owners in circumstances where access is required for persons to enable them to compete in upstream or downstream markets. To be successful this will generally require regulation or other incentives to guard against monopoly pricing, artificial constraints on capacity and anti-competitive behaviour.

The subsidiary objective is to establish light handed regulatory procedures. Such procedures should be flexible enough to accommodate individual circumstances, not generate unnecessarily high administrative and compliance costs, but be binding on service providers and users.

3. National Third Party Access Code

The National Third Party Access Code for Natural Gas Pipeline Systems (the Code) aims to provide access to the services provided by monopoly pipeline assets. On 7 November 1997, the Australian Heads of Government agreed to implement the Code. Given that the Code confers powers on Commonwealth bodies such as the ACCC and the NCC, Commonwealth legislation and complementary legislation in each State and Territory is required. The Commonwealth recently passed the *Gas Pipelines Access (Commonwealth) Bill 1998*, while the South Australian, Northern Territory and New South Wales legislation have already been proclaimed and other states are set to follow.

The Code aims to achieve a uniform national framework for third party access to natural gas pipeline systems, and to facilitate the development and operation of a national market for natural gas by providing rights of access to pipelines on fair and reasonable terms. In essence, therefore, it aims to address both of the regulatory problems identified above - it tries to ensure third parties, such as downstream competitors, have access to the services provided by gas pipelines and that the terms and conditions upon which those services are obtained are fair and reasonable.

4. ACCC Role in Gas Industry Reforms

Under the *Gas Pipelines Access Law*, the relevant regulator for gas pipelines differs according to the type of pipeline under consideration. The ACCC is the relevant regulator for access to services provided by transmission networks in all States and Territories except Western Australia. Distribution networks will be regulated by independent State-based regulators, except in the Northern Territory, which has requested the ACCC regulate both its transmission and distribution pipelines.

This new and diverse range of regulatory functions has brought out the importance of State and Federal regulators coordinating their assessment of cross-jurisdictional applications for regulatory approval. To this end, jurisdictional regulators have formed the Utility Regulators' Forum which seeks to coordinate research and regulatory response to a wide range of issues, including information requirements of regulators, ring-fencing of accounting information, monitoring of quality standards, 'best practice' and benchmarking, appeals processes and regulatory data bases. The ACCC also has an Energy Committee on which the heads of State counterpart agencies, who are *ex-officio* members of the ACCC, have input to the ACCC's regulatory decisions and regional considerations can be taken into account.

5. Incentive Regulation and the National Gas Code

Most of the access pricing principles under the National Gas Code are contained within chapter 8 of the Code. The Commission seeks to minimise the regulatory burden on industry (and hence lower the overall cost to consumers) by maximising competition wherever possible. In cases of natural monopoly, where competition is typically neither feasible nor efficient, the Commission generally seeks to create a set of incentives which encourage those in positions of market power to conduct their business in a socially desirable manner without the regulator having to second guess their every move. Facilitation of competitive secondary markets in service provision,

such as pipeline capacity, is an efficient method of reallocation and can provide valuable information for the ongoing regulation of the primary Service Provider.

The theoretical underpinning for incentive regulation is that with the ability to retain cost reductions as profits, the service provider has a strong incentive to be more efficient in the provision of access services and to expand its market share and to contribute to market growth. Higher than expected performance in both these areas will lead to better than initially-expected profits and better utilisation of resources. Generally, users of the services benefit directly only in future periods after regulated prices are subjected to review and the new cost structures are taken into account when re-establishing the regulated prices.

To achieve the potential efficiency gains from competition in upstream and downstream markets, it is important that the prices of access not reflect the exercise of market power by the service provider and that the structure of pricing to various users and between different categories of service be based on the costs involved in providing each service. The price paths for services in question are usually defined at the beginning of a review period to achieve these ends.

If regulation adjusts prices to simply allow the service provider to recover costs and achieve a normal rate of return on investment, the service provider will have little incentive to be efficient in the provision of such services; indeed there may be an incentive to reduce efficiency. Hence the need for incentive-based regulatory mechanisms.

Most incentive mechanisms seek to avoid heavy handed revenue control and to divorce the permitted charges for access from the reductions in costs or efficiency gains the service provider is able to achieve over and above those that were expected at the beginning of a review period. Hence above-normal profits are only restrained after the period under review has passed and the regulator looks forward to the next period.

There is a welter of analytical tools available to policy-makers, regulators and stakeholders to shape or check on incentives to achieve a higher level of cost efficiency in the regulated firm. They can also be used to generate incentives for investment at levels that are consistent with allocative and dynamic efficiency in the industry, and a sharing of the benefits of regulation between the firm, the customer and the community.

It is important to remember that although the regulatory control over the earnings of private assets may appear somewhat heavy handed, as natural monopolies they impact on the earnings of the wider community and they perform a public function, for instance, in transmitting telephony messages or electricity over the wires by the path of least resistance. Therefore the public have an interest in the efficiency, safety, cost and other aspects of how that job is done.

The ACCC will not proceed to make determinations without public consultation, which, importantly, includes the asset owner. While investment in infrastructure is essentially an industry decision, the Commission will regulate with the objective that such decisions are not distorted by access conditions being too harsh (e.g., access prices

set too high, leading to either a lessening of competition or wasteful duplication) or too lax (e.g., access prices set too low, leading to inefficient use of existing facilities). The aim is to encourage decision-making consistent with maximising benefits to users and the community.

It is essential that reform outcomes be objectively reviewed from time to time, taking care to distinguish outcomes of reform initiatives from inevitable pricing trends consistent with technological change and to distinguish and have regard both to the level of competition and to the level of enhancement of competitive capacity, which includes such dimensions as research and development, and expenditure on exploration and infrastructure development.

6. ACCC Experience in Implementing the Code

I would now like to consider some of the ACCC's recent experience as transmission regulator in the Victorian gas industry.

In order to expedite its gas reform process, the Victorian government introduced a transitional access Code, which is identical in all material respects to the National Code. The Victorian government nominated the ACCC as transmission regulator and the Office of Regulator General (ORG) as the distribution regulator. The Victorian Government simultaneously submitted its gas access regime and associated access arrangements to the National Competition Council (NCC) for effectiveness certification; the ACCC for approval of their transmission access arrangements; and to ORG for approval of their distribution access arrangements. The access arrangements set out the terms and conditions on which access to transmission services will be made available to third parties in Victoria.

Applications were also submitted for the authorisation of the Victorian Market and System Operations Rules (MSOR) which govern wholesale spot market operation, and provide for systems security, connection to the transmission system, dispatch and metering.

On 28 May 1998, the ACCC released its Draft Decision on the three Victorian Gas Transmission Access Arrangements and its Draft Determination on the MSOR. The preliminary decisions proposed by the ACCC are to approve the access arrangements subject to certain amendments being made and grant conditional authorisation to the MSOR. The ACCC has now released its final determination authorising the MSOR and its final decision on the Access Arrangements was handed down this week.

The most controversial issue arising out of the Draft Decisions was the choice of an appropriate weighted average cost of capital (WACC) for the access arrangements. The WACC is essentially the rate-of-return allowed on the capital base. It is calculated as a weighted average of returns investors could otherwise achieve through various industry-specific debt and equity instruments. The ORG and the ACCC used a similar approach in determining the WACC for both transmission and distribution assets, and calculated a **real pre-tax** figure of 7%. Concerns were expressed within the industry, as well as by potential investors and the Victorian Government that the figure was too low.

The Commission yesterday released its final decision on the Victorian access arrangements, and both the ACCC and the ORG have determined a real pre-tax WACC of 7.75%, which is equivalent to a nominal after tax return on equity of at least 13.2%. A private investor, however, may obtain a higher effective rate than this due to the tax benefits flowing from the operation of Australia's tax system.

The assessment of the rate of return requires the regulator to determine a rate which is fair to both the utility owner and customers. In other words, a rate that restricts monopoly profits yet still provides a reasonable return on the investment. In addition, the intent of the reform process at both the national and state levels is to encourage the provision of competitive inputs for Australia's existing and prospective energy intensive industries and to encourage the delivery of competitively priced gas to consumers.

7. Upstream Reform

The development of effective competition in both downstream and upstream gas markets in Australia is of vital concern to the ACCC. The reforms implemented to provide pipeline access should drive greater competition in the downstream gas retail markets. However, the benefits of these reforms may be severely limited or not eventuate if there is a lack of competition upstream.

The primary objective of gas reform is to remove any barriers that may inhibit free and fair trade in gas, to encourage a competitive gas supply industry. The greater the number of participants competing in the supply of gas, the better for users and the community as a whole, which benefits at least indirectly as a result of the lower production costs faced by power generators and manufacturers.

Aggregation of production interests and coordinated marketing arrangements of gas production joint ventures in the main Australian gas basins are potential obstacles to the development of a competitive interconnected, multi-state Australian gas market. The Commission is aware that the achievement of a more competitive market structure in the upstream gas production sector will be a difficult task, particularly in basins where gas production and use is project-focused and associated with members of the joint venture contracting on common terms with customers for large, long-term quantities of gas.

The Australian Competition Tribunal, in its recent decision concerning the AGL Cooper Basin supply arrangements, recognised that there must be a balancing of "the forces that may limit the prospects for effective competition." The tribunal recognised that common ownership of exploration leases, production facilities, the existence of economies of scale in the development of reserves and the construction of pipelines in gas fields may all raise barriers to entry and restrict the numbers of viable participating enterprises, with a resulting impact on gas consumers.

Inter-basin competition

Inter-basin competition is an important first step towards a fully competitive gas supply industry. As new pipeline interconnections are established, markets that have been subject to a single supplier for over twenty years will have the prospect of

sourcing their gas from another supplier. While the Commission expects inter-basin competition to be of some benefit, two or three suppliers is rarely sufficient for a fully competitive market to eventuate.

So while inter-basin competition is a desirable and appropriate short-term objective, it is critical that measures be put in place now that will facilitate intra-basin competition in the medium to longer term.

Jurisdictions need to make changes now that will encourage the entry of new explorers into existing producing basins, because of the lags from exploration to potential production. This means that acreage management and access to upstream facilities are critical in making gas discoveries more likely to be economic to produce.

There are a number of new prospective gas supply sources, including Papua New Guinea and the Timor Sea, which can feed into an East Australian grid and, through swaps, backhauls and other flexible marketing and transportation arrangements, impact on gas supply throughout the region. Some areas, such as Moomba and Wallumbilla, are positioned in such a way that they lend themselves to development as natural hubs. They could be managed in a way that encourages flexible transportation and gas swap arrangements.

This would allow brokers and aggregators to better match supply and demand, providing confidence to small producers that they are able to sell the volumes of gas which would otherwise be difficult to market.

While such a competitive gas supply industry may still seem far off, a number of steps need to be taken now to ensure that it becomes a reality.

Third Party Access to Upstream Facilities

The Commission is concerned that access to transmission and distribution pipelines alone is unlikely to deliver competitive outcomes to downstream industrial and household gas users unless obstacles limiting upstream competition are overcome. Access to upstream facilities is one of the means of enhancing competition upstream.

The benefits of access to upstream facilities in contrast to the cost of duplicating facilities have been stated by industry players themselves in an application for Authorisation submitted by Santos Ltd & Ors to the Commission:

it is undoubtedly more efficient given that facilities do exist to process both wet and dry gas, and given also that the Unit Parties (who are now the same as the Patchawarra Southwest and Murta Block parties) have invested considerably in constructing them, that the Patchawarra Southwest and Murta Block parties continue to toll their product through existing facilities rather than construct new plant. Stand alone economics which were undertaken by Patchawarra Southwest and Murta parties established that it was less economic for those joint ventures to build their own plant than for them to toll through Moomba. The economics

supporting this conclusion have not changed. Tolling is therefore of benefit to the public.³

Infrastructure costs will be a major consideration for any potential new entrants and will impact on their ability to compete successfully.

The Commission notes that access to upstream facilities is an important aspect for new players to consider before entering a market. It is likely to have a significant impact on whether potential new entrants bid for acreage in existing production areas following the relinquishment of exploration licences.

A study by MESA⁴ found that, in the absence of access to existing processing facilities, for new investment to be economic a minimum field size exceeding 35 billion cubic feet (BCF) of recoverable raw gas would be required. In contrast, fields with as little as 5 BCF of recoverable raw gas were found to be economic if access to existing facilities is negotiated on a deprival value cost basis. In this context, while the ACCC is of the view that reducing the size of exploration permit areas could have the potential to enhance competition, it also recognises that this competition may not be realised unless new entrants have access to existing facilities on reasonable terms. In fact, the perceived inability to gain access to existing facilities could be a barrier to potential new entrants from bidding for acreage at all. These concerns are magnified by the fact that future discoveries in already producing basins are likely to be smaller, as it could be expected that the previous exploration would have identified the largest fields.

Part IIIA of the Trade Practices Act 1974 (TPA) establishes a legislative regime to facilitate third party access to the services of certain essential facilities of national significance. However, s.44B excludes from the regime some services which include those relating to the supply of goods and the use of a production process, '*except to the extent that it is an integral but subsidiary part of the service*'⁵. Upstream gas facilities are predominantly for the purpose of gas supply and production. Thus Part IIIA does not apply to these facilities unless they are an integral but subsidiary part of a service already covered by Part IIIA (a covered service). It appears that whether upstream facilities form an integral but subsidiary part of a covered service would depend on the facts of the case. Particularly in the case of upstream gas processing facilities, the general view is that they would not be an integral but subsidiary part of a gas transportation service and thus would not be covered by Part IIIA.

In a report by Mr Nick Dyki, Independent Investigator, on the Cooper Basin (Ratification) Act Review, Mr Dyki recommended that the State implement a third party access regime for the Cooper Basin facilities either via legislation or an Industry Code. The ACCC believes that an Industry Code can address the concerns raised above, and that a national industry code for access to upstream facilities should be developed. For such a code to be effective however, it must be binding on all relevant parties and should contain the following elements:

³ Santos Ltd & Ors, Application for Authorisation No. A90560, 18 February 1994, Annexure 2, par 70.

⁴ R C M McDonough, Mines and Energy South Australia, *Economics of Gas Field Developments in the Cooper Basin After 1999*, APPEA Journal, 1997.

⁵ Trade Practices Act 1974, section 44B - Definitions

1. Stated public principles on which spare capacity in the system or parts of the system will be determined.
2. Provide up-to-date public data as to when capacity will be available and for what services.
3. A compulsory dispute resolution process that has clear principles and processes and is cost effective, timely, efficient, and available for use by potential entrants to the industry.
4. The principles upon which the price for access to spare capacity will be calculated should be publicly available. These principles would take into account factors such as:
 - the method to be used in determining asset values;
 - the weighted average cost of capital;
 - appropriate recoverable costs;
 - capital base and capital contributions;
 - new facilities investment;
 - surcharges for incremental capacity;
 - capital redundancy;
 - rate of return;
 - depreciation schedule;
 - non-capital costs;
 - allocation of costs between services and users;
 - prudent discounts; and
 - the use of incentive mechanisms.

Given the importance of access to upstream facilities to the success of the reform process and the fact that Part IIIA of the TPA does not provide for access to processing facilities, the introduction of an effective national third party access regime for upstream facilities via the participation of the respective State Governments is vital. The ACCC notes that the South Australian Government's preliminary response to the Ratification Act review included 'the establishment of a transparent process enabling the consideration of any firm, third party access application to use Cooper Basin gathering systems or Moomba plant. The ACCC endorses in principle such an approach, if the code provides reasonable rights of access to facilities comparable with the principles listed above.

Marketing Arrangements

Coordinated marketing and separate marketing

Presently, coordinated marketing of gas by joint venture partners is common practice in the Australian gas industry. This may be attributed to the fact that gas markets in Australia operate as 'contract' or 'project' markets, where gas is only produced to meet specific and often long-term contractual obligations. Such a market structure may create practical problems which currently make separate marketing not feasible.

On 29 July 1998, the ACCC approved an application for authorisation submitted by the North West Shelf Project in Western Australia. The applicants had sought an authorisation to enable parties involved to discuss and agree together the common terms and conditions, including price and methods for marketing and selling the gas produced by the project (coordinated marketing). While recognising that coordinated marketing may act as a barrier to entry to the gas market, the Commission found that separate marketing was not currently viable in an environment of few producers and buyers; a predominance of long term contracts; and the absence of spot and secondary markets.

Notwithstanding the decision to authorise the North West Shelf project, the Commission is aware of the ongoing evolution of gas markets in Australia and has identified a list of market features which are present in other gas markets where separate marketing is the norm. These include:

- a large number of customers creating a diverse gas demand profile;
- a number of competitive suppliers;
- a range of transportation options creating a pipeline grid;
- storage close to demand centres;
- brokers/aggregators providing supply and/or demand aggregation services as well as bundled supply packages;
- gas-related financial markets; and
- significant short term and spot markets.

Clearly, where possible, separate marketing is more competitive than joint marketing and is to be preferred. By creating price competition between as many suppliers of gas as possible, separate marketing should result in lower prices and more choices for consumers and users of gas.

Coordinated marketing of gas by joint venture producers may be in breach of the TPA but can be authorised if the public benefits exceed the anti-competitive detriments. The TPA provides an appropriate mechanism for the transparent consideration of

whether coordinated marketing is in the public interest. The authorisation process also provides a mechanism for review if the circumstances change materially. The Commission believes that the authorisation provisions of the TPA are the appropriate mechanism for considering coordinated marketing and that no additional specific legislative regime is required. We also believe that State Governments should not grant exemptions from the operation of the TPA for coordinated marketing, but rather allow the same transparent authorisation process to apply to all gas producers. This will be even more important as jurisdictions are inter-connected and basins begin to compete.

Gas supply contracts

Long-term contractual arrangements for gas supply is a main feature of Australian gas supply contracts. Such arrangements may have their merits as well as detriment.

The Australian Competition Tribunal, in handing down its decision on AGL's Cooper Basin Natural Gas Supply Arrangements, recognised that long-term contractual arrangements may be required so that borrowings for significant capital expenditure can be secured against the cash flow of the venture. The Tribunal indicated that the term of a contract that provides the necessary cash flow should be properly related to the period within which borrowings are to be amortized. It further observed that

there may also be other commercial circumstances where the assurance of a lengthy contract term is required if the public benefit to be derived from a major development is to be realized. In such circumstances,... a lengthy contract term does not necessarily represent a detriment, but rather may contribute to the achievement of a benefit.

However, the Tribunal also noted that some provisions allow for suppliers to extend the term of contract or refuse gas supply additional to the contract quantities. These provisions could prove anti-competitive if applied rigorously. It was of the view that 'take-or-pay' formula might be acceptable in the past to the effect that it was used to secure cash flow. But it is no longer acceptable in today's more sophisticated financial environment where preferable contractual devices that serve the same end are available.

8. Victorian Gas Crisis

The explosion that extensively damaged and temporarily shut down Victoria's main gas processing plant at Longford, crippling the State's gas supplies, highlights the vulnerability of Victoria to the dominant gas supplier, Esso-BHP. That dominance is the result of State policies of thirty years ago, when reserves were being proved for development. Contractual arrangements, a prohibition at the time on interstate sales and State revenue-raising arrangements brought about an interdependence between the producers and the local State market, which has had continuing effects to this day. The upshot of all of this is that Victoria has no real alternative sources of gas

supply, and that the lack of competition has wreaked havoc on the State both economically and socially.

The circumstances are similar in other States.

That situation has explained in part the past reluctance in Victoria to bring on new production areas. Provided the economics of production support them, new areas would introduce supply options beyond that of the dominant producer, giving a measure of greater production security.

Whether greater security in processing can be fostered by stand-alone processing by new producers depends very much on the economics of processing. In some cases (such as near Moomba in the Cooper Basin), studies suggest that tolling arrangements would be more economic for the new entrant. In those cases security of processing comes down to plant design and operations.

Earlier this year a \$50 million interconnection between the New South Wales and Victorian systems was completed, allowing gas from the Cooper Basin to flow into the Victorian network. This pipeline was fostered by national competition policy reform involving an agreement signed by the States to implement free and fair trade in gas.

I have seen comments suggesting that the solution to the Victorian crisis is greater interconnection. While that argument has merit, it will only be with the liberalisation of supply markets that utilities and users will have greater choice of supply arrangements tailored to their price and risk requirements. If that liberalisation is to occur, States must foster the development of competition between gas production areas and between companies operating in production basins, as far as possible.

Conclusion

The ACCC believes that enhanced competition in gas markets will provide benefits to consumers through greater choice, lower prices and improved services and will also provide flow-on benefits to the Australian economy as a whole. The development of competitive downstream gas markets depends significantly on effective competition upstream among producers of gas. It is therefore desirable for governments to undertake concerted efforts to address upstream competition issues to ensure that reforms to free up downstream gas markets achieve their objectives.

The Commission is aware that the achievement of a more competitive market structure in the upstream gas production sector will be a difficult task, particularly in basins where gas production and use is project-focused and associated with members of the joint venture contracting on common terms with customers for large, long-term quantities of gas. Given local market characteristics, Australia is unlikely to match the level of competitive activity in the USA and Canada. However, the prospective development of secondary-market trading in gas and pipeline capacity, the interconnection of pipelines and the development of gas swap opportunities and gas storage will encourage market entry and growth and an environment sustaining greater competition between producers, if complemented by upstream reform initiatives in relation to acreage management, flexibility of delivery points, replacement

of take-or-pay by more efficient two-part tariffs, and third-party access to gas gathering and processing facilities.

Acreage Management Systems

Initiatives must be undertaken by State governments to enhance contestability of tenements by increasing the transparency of tenement award and management.

It is clear that for prospective acreage, granting exploration permits of smaller size and for shorter duration will allow more explorers to be involved in gas exploration and potentially enhance supply competition. This is especially the case in previously explored or particularly prospective regions or where gas is already being produced. In such areas, the Commission advocates permit sizes that are as small and for as short a time period as considered economically viable.

The Commission also recommends that the selection criteria for allocation of PELs be amended to allow bidders who are not currently producers in the region to propose additional public benefits that would arise as a result of greater competition should they find gas.

Access to upstream facilities

Access to upstream facilities is an important aspect for new players to consider before entering a market. It has a significant impact on whether potential new entrants bid for acreage in existing production areas following the relinquishment of exploration licences.

Given the importance of access to upstream facilities to the success of the reform process and the fact that Part IIIA of the TPA does not provide for access to processing facilities, the introduction of an effective national third party access regime for upstream facilities via the participation of the respective State Governments is vital.

Marketing arrangements

Coordinated marketing of gas by joint venture producers may be in breach of the TPA but can be authorised if the public benefits exceed the anti-competitive detriments. The TPA provides an appropriate mechanism for the transparent consideration of whether coordinated marketing is in the public interest. The authorisation process also provides a mechanism for review if the circumstances change materially. The Commission believes that the authorisation provisions of the TPA are the appropriate mechanism for considering coordinated marketing and that no additional specific legislative regime is required. The Commission further believes that State Governments should not grant exemptions from the operation of the TPA for coordinated marketing, but rather allow the same transparent authorisation process to apply to all gas producers. This will be even more important as jurisdictions are inter-connected and basins begin to compete.