Australian Competition Tribunal Decisions

Re Duke Eastern Gas Pipeline Pty Ltd [2001] ACompT 2 (4 May 2001)

Last Updated: 9 May 2001

AUSTRALIAN COMPETITION TRIBUNAL

Duke Eastern Gas Pipeline Pty Ltd [2001] ACompT 2

TRADE PRACTICES - access to pipelines - application for review of the decision of the Minister for Industry, Science and Resources to cover the Eastern Gas Pipeline - pipeline must be covered if Tribunal satisfied of criteria (a), (b), (c) and (d) of s 1.9 of the *National Third Party Access Code for Natural Gas Pipeline Systems* - whether access or increased access to services provided by means of the pipeline would promote competition in at least one market other than the market for the services provided by means of the pipeline under criterion (a) - construction of "access" - construction of "services provided by means of the pipeline" - construction of "promote competition" - definition of market - whether coverage of the pipeline would promote competition in upstream or downstream markets to a greater extent than existing voluntary access - existence of spare capacity in pipelines - whether long term contracts will restrict competition - existence of market power.

Whether it would be economic for anyone to develop another pipeline to provide the services provided by means of the pipeline under criterion (b) - whether existing pipelines should be considered in determining whether criterion (b) is satisfied - construction of "uneconomic" - whether for a likely range of demand for the services provided by means of the pipeline it would be more efficient, in terms of costs and benefits to the community as a whole, for one pipeline to provide those services rather than more than one - unnecessary for the Tribunal to give independent consideration to criterion (d)

WORDS AND PHRASES - "to develop another pipeline" - "uneconomic" - "services provided by means of the pipeline" - "access" - "promote competition"

Trade Practices Act (1974) (Cth) Part IIIA

Gas Pipelines Access (Victoria) Act 1998 (Vic)

Gas Pipelines Access (NSW) Act 1998 (NSW)

Gas Pipelines Access (South Australia) Act 1997 (SA), Sch1

Sherman Anti-Trust Act 1890 (USA) s 2

Competition Policy Reform Act 1995 (Cth)

Moomba to Sydney Pipeline System Sale Act 1994 (Cth)

Gas Pipelines Access Law, s 38(1) 38(9), (12), s 39

National Third Party Access Code for Natural Gas Pipeline Systems, ss 1.1, 1.13, 1.24, 1.3, 1.6, 1.9 (a), (b), (c), (d)

Gas Pipelines Access (South Australia) Bill, Second Reading Speech, 2 December 1997

Competition Policy Reform Bill, Second Reading Speech, 30 June 1995

Hilmer Committee, *Report by the Independent Committee of Inquiry*, *"National Competition Policy"* (August 1993)

National Competition Council, *Draft Recommendation on Application for Coverage of Eastern Gas Pipeline* (May 2000)

National Competition Council, *Final Recommendation on Application for Coverage of Eastern Gas Pipeline* (June 2000)

National Competition Council, *The National Access Regime: A Draft Guide to Part IIIA of the Trade Practices Act* (August 1996)

Posner, *Natural Monopoly and its Regulation* (3rd edition, 1999)

Re: Review of Freight Handling Services at Sydney International Airport (2000) ATPR¶41-754 considered

AGL Cooper Basin Natural Gas Supply Arrangements (1997) ATPR¶41-593 cited

Re Queensland Co-Operative Milling Association Ltd (1976) 25 FLR 169 cited

MATTER NO 3 OF 2000

RE: APPLICATION UNDER SECTION 38(1) OF THE GAS PIPELINES ACCESS LAW FOR REVIEW OF THE DECISION BY THE MINISTER FOR INDUSTRY, SCIENCE AND RESOURCES PUBLISHED ON 16 OCTOBER 2000 TO COVER THE EASTERN GAS PIPELINE PURSUANT TO THE PROVISIONS OF THE NATIONAL THIRD PARTY ACCESS CODE FOR NATURAL GAS PIPELINE SYSTEMS AND THE GAS PIPELINES ACCESS LAW

JUSTICE HELY, DR M J MESSENGER & MISS M M STARRS

4 MAY 2001

SYDNEY

IN THE AUSTRALIAN COMPETITION TRIBUNAL MATTER NO 3 OF 2000

RE:	APPLICATION UNDER SECTION 38(1) OF THE GAS PIPELINES ACCESS LAW FOR REVIEW OF THE DECISION BY THE MINISTER FOR INDUSTRY, SCIENCE AND RESOURCES PUBLISHED ON 16 OCTOBER 2000 TO COVER THE EASTERN GAS PIPELINE PURSUANT TO THE PROVISIONS OF THE NATIONAL THIRD PARTY ACCESS CODE FOR NATURAL GAS PIPELINE SYSTEMS AND THE GAS PIPELINES ACCESS LAW.
BY:	DUKE EASTERN GAS PIPELINE PTY LTD DEI EASTERN GAS PIPELINE PTY LTD DUKE AUSTRALIA OPERATIONS PTY LTD

MEMBERS:	JUSTICE HELY, DR M J MESSENGER & MISS M M STARRS
DATE OF DETERMINATION:	**4 MAY 2001**
WHERE MADE:	SYDNEY

THE TRIBUNAL ORDERS THAT:

1. The decision of the Minister made on 16 October 2000 that the Eastern Gas Pipeline should be a covered pipeline be set aside.

2. In lieu of that decision the Tribunal decides that the Pipeline is not covered.

3. There be liberty to apply by motion filed prior to 10 am on Tuesday 8 May 2001 for an order as to costs, any such motion to be made returnable before the Tribunal by arrangement with the associate to the Deputy President. Unless such a motion is filed, there is to be no order as to the costs of the proceedings.

IN THE AUSTRALIAN COMPETITION TRIBUNAL MATTER NO 3 OF 2000

RE:	APPLICATION UNDER SECTION 38(1) OF THE GAS PIPELINES ACCESS LAW FOR REVIEW OF THE DECISION BY THE MINISTER FOR INDUSTRY, SCIENCE AND RESOURCES PUBLISHED ON 16 OCTOBER 2000 TO COVER THE EASTERN GAS PIPELINE PURSUANT TO THE PROVISIONS OF THE NATIONAL THIRD PARTY ACCESS CODE FOR NATURAL GAS PIPELINE SYSTEMS AND THE GAS PIPELINES ACCESS LAW.
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MEMBERS:	JUSTICE HELY, DR M J MESSENGER & MISS M M STARRS
DATE:	4 MAY 2001
PLACE:	SYDNEY

REASONS FOR DECISION

THE TRIBUNAL:

1 The Eastern Gas Pipeline ("the EGP") is a transmission pipeline transporting Gippsland Basin natural gas from the Longford gas production facility in Victoria to Horsley Park, near Sydney, New South Wales. The EGP is owned by Duke Eastern Gas Pipeline Pty Ltd and DEI Eastern Gas Pipeline Pty Ltd and is operated by Duke Australia Operations Pty Ltd ("EGP"). The EGP is situated in the jurisdictional areas of the State of Victoria and the State of New South Wales, hence both the *Gas Pipelines Access (Victoria) Act 1998* and the *Gas Pipelines Access (NSW) Act 1998* have application in relation to the pipeline.

2 Those Acts and corresponding legislation passed by the Commonwealth and the other States and Territories of Australia enact the "Gas Pipelines Access Law", which is intended to provide a uniform national framework applicable to third party access to all gas pipelines. The "Gas Pipelines Access Law" consists of Schedule 1 to the *Gas Pipelines Access (South Australia) Act 1997* entitled "Third Party Access to Natural Gas Pipelines" (which, for convenience we will refer to as "the Law") and the *National Third Party Access Code for Natural Gas Pipeline Systems* (which, for convenience we will refer to as "the Code").

3 The Code is "a regulatory framework to govern third party access to natural gas pipeline systems, in accordance with the provisions of Part IIIA of the *Trade Practices Act* and the *Competition Principles Agreement": Gas Pipelines Access (South Australia) Bill*, Second Reading Speech, 2 December 1997 Hansard at 17. The notion underlying it and Part IIIA of the *Trade Practices Act 1974* (Cth) ("TPA") is that "access to certain facilities with natural monopoly characteristics, such as electricity grids or gas pipelines, is needed to encourage competition in related markets, such as electricity generation or gas production" (*Competition Policy Reform Bill*, Second Reading Speech, 30 June 1995 Hansard at 2799).

4 On 7 January 2000 an application was made to the National Competition Council ("NCC") by AGL Energy Sales & Marketing Ltd, pursuant to s 1.3 of the Code, requesting that the EGP be a covered pipeline in terms of the Code and the *Gas Pipelines Access Law*. On 8 May 2000, pursuant to s 1.6 of the Code, the NCC issued its Draft Recommendation on the application. It will be necessary to return to the terms of the Draft Recommendation later in these reasons. On 3 July 2000 NCC issued its Final Recommendation to the Minister. That recommendation was that the EGP be covered, as NCC was satisfied that all four criteria in s 1.9 of the Code were met in respect of the whole of the pipeline. On 16 October 2000, pursuant to s 1.13 of the Code, the "Relevant Minister", the Hon Senator Nick Minchin, decided that the EGP should be a covered pipeline in accordance with NCC's Final Recommendation.

5 A decision to cover a pipeline can have major commercial implications for the owner or operator of the pipeline. Where a pipeline is covered, the "Service Provider" (the owner or operator of the pipeline) must establish an arrangement for access to the pipeline (an "Access Arrangement") that has been approved by the "Relevant Regulator", which, in the case of the EGP, is the Australian Competition & Consumer Commission ("ACCC"). In very general terms, an Access Arrangement is a statement of the policies and basic terms and conditions, including the tariff structure, which apply to third party access to the pipeline. The Code contains detailed requirements as to the terms of Access Arrangements, and as to the information which must be disclosed to the market in association therewith. The Code also obliges the Service Provider to segregate, or "ring fence", its business of providing services using the pipeline. Section 4 of the Code contains quite detailed provisions as to how a service provider is to "ring fence" its pipeline activities from other operations conducted by entities in the group of which it forms a part. Coverage of the EGP will result in significant compliance and regulatory costs being incurred by the operator of the EGP, in addition to exposing its tariff structure to regulatory control.

6 Section 38 of the Law provides for a "review" of the Minister's decision by the Tribunal. The Tribunal may exercise the same powers with respect to the subject matter of the decision as the Minister: s 38(9). A determination by the Tribunal on the review of the Minister's decision has the same effect as if it were made by the Minister: s 38(12). The section is otherwise silent as to the nature of the "review" for which it provides, but is to be contrasted with the "review" of access arrangements for which s 39 of the Law makes provision. Section 39 contains explicit limitations on the review process, including limitations upon the grounds of review, and upon the materials which may be considered during the review. In very general terms, a s 39 review is restricted to a consideration of the materials which were before the Relevant Regulator, and is dependent upon the demonstration of particular types of error on the part of the Relevant Regulator. Those limitations are not replicated in s 38.

7 The application currently before the Tribunal is for a review of the Minister's decision that the EGP should be "covered", ie that the EGP is subject to the provisions of the Code pursuant to s 1.13.

Background

8 In 1963 gas was discovered in the Cooper Basin in north-eastern South Australia. The gas field was developed by a consortium of companies, known as the Cooper Basin Producers, of which Santos Ltd is the principal member. In 1964 gas was discovered offshore, in the Gippsland Basin, in Bass Strait. The Producers in the Gippsland Basin are related companies of BHP or ESSO.

9 After competitive negotiations with the Producers in each Basin, in 1971 the Australian Gas Light Company ("AGL") selected the Cooper Basin Producers as the preferred long term source of supply of natural gas to Sydney, and negotiated a letter agreement with the Cooper Basin Producers, or some of them, to that effect.

10 Historically, AGL supplied gas to retail customers in NSW, including to all customers in Sydney. AGL was a statutory monopoly. However, this is now changing as competition is introduced into the NSW gas market. Contestable customers are able to choose their supplier of gas from competing gas retailers. A number of gas retailers now compete with AGL, and it is expected that by July 2001 all gas consumers in NSW will be contestable customers. At present, it is only the larger users of gas who are contestable customers.

Moomba to Sydney Pipeline ("the MSP")

11 The MSP is 1,299 km long, and runs from the outlet of the gas processing plant at Moomba to Wilton, approximately 60 km south-west of Sydney CBD. Wilton is described as the "city gate" for the supply of natural gas to the Sydney region. Construction of the MSP was completed in 1976. Subsequently, lateral pipelines were constructed from the MSP to Wollongong, Newcastle, Dubbo, Orange, Lithgow, Oberon, Griffith, Wagga Wagga and Canberra.

12 In 1976 AGL, pursuant to an agreement with the Cooper Basin Producers, completed the construction of a further section of transmission pipeline from Wilton to Horsley Park, in western Sydney. The Wilton to Horsley Park trunk line is about 52 km in length, and connects the MSP to the AGL Gas Networks Limited ("AGLGN") distribution network in the Sydney metropolitan area.

13 The MSP was constructed by a Commonwealth statutory authority, The Pipeline Authority, and was sold to East Australian Pipeline Limited ("EAPL") in 1994. EAPL is the owner and operator of the MSP. Originally, AGL was a substantial shareholder in EAPL. In June 2000 all of the shares in EAPL were purchased by Australian Pipeline Ltd ("APL"), as trustee of the Australian Pipeline Trust ("APT"), a listed unit trust. AGL holds 30 per cent of the units issued in the Trust. The marketing of the transportation services offered by MSP is undertaken by EAPL, but the pipeline is physically operated by Agility Management Pty Ltd, a subsidiary of AGL.

14 The sale of the MSP to EAPL in 1994 was pursuant to the *Moomba to Sydney Pipeline System Sale Act 1994* (Cth) ("the Sale Act"). Under the Sale Act, the owner of the MSP was required to provide third party access to shippers (a term used to define those persons who contract with a pipeline owner for transport of gas) and in the event of a dispute as to access, the Trade Practices Commission was nominated as the arbitrator.

15 When the *Gas Pipelines Access Law* was enacted in 1998, the MSP became a covered pipeline from the date of commencement of the Code, pursuant to s 1.1 of the Code, as the MSP was amongst the pipelines listed in Schedule A to the Code. Under grandfathering provisions in the NSW legislation, the Independent Pricing and Regulatory Tribunal ("IPART") will continue to determine prices and access terms and conditions for the AGL gas transmission and distribution systems throughout NSW, including the Wilton to Horsley Park trunk line owned by AGL, until July 2001.

16 On about 28 April 2000 EAPL applied to NCC to revoke coverage of a portion of the MSP, including the main pipeline running from Moomba to Wilton, as well as certain of the lateral pipelines branching off it. Section 1.24 and ff of the Code provide for applications to revoke coverage of a pipeline. The procedure for revocation of coverage is similar to the procedure required to be followed where coverage of a pipeline is sought. The Relevant Minister must decide to revoke coverage if not satisfied of one or more of the matters set out in pars (a) to (d) of s 1.9 of the Code, but must maintain coverage if satisfied as to all of these matters. Revocation of coverage was sought on the basis that once construction of the EGP was completed (as it was in September 2000), EAPL and Duke:

> *"will be in direct competition to supply gas transmission services to retailers in the Sydney and Canberra markets. ... Competition is expected to be fierce."*

17 NCC recommended that coverage of the MSP not be revoked, as it was satisfied that all four criteria in s 1.9 of the Code were met in respect of the pipeline. On 16 October 2000 the Minister decided that coverage should not be revoked, consistent with the NCC's recommendation.

18 During 1999 proposed Access Arrangements for the MSP were submitted by EAPL to ACCC for approval. On

19 December 2000 ACCC issued a Draft Decision in which it proposed that those arrangements would not be approved. The draft indicated the nature of the amendments which would need to be made if ACCC approval of the Access Arrangement was to be forthcoming. The practical effect of the implementation of the Draft Decision would be a substantial decrease in price for transportation of gas in the MSP.

The Interconnect

19 Natural gas from the Gippsland Basin is processed at Longford in Gippsland, east of Melbourne. Historically Gippsland gas has been predominantly consumed in Melbourne and regional Victoria. A number of comparatively complex structural changes have occurred in the Victorian gas market in recent years. For present purposes it is sufficient to record that GPU GasNet Pty Ltd ("GasNet") presently owns and maintains Victoria's 1,800 kms of natural gas transmission pipelines.

20 Prior to the construction of the Interconnect in 1998, the Victorian system included a pipeline from Melbourne to Barnawartha (immediately south of Albury) in Northern Victoria. The NSW system included a lateral pipeline running southwards from the MSP at Young to Wagga. In 1998 a pipeline was jointly built by EAPL and one of GasNet's predecessors from Barnawartha to Wagga to interconnect with the MSP lateral between Young and Wagga. The pipeline from Barnawartha to Wagga is known as the Interconnect. It interconnects the Victorian transmission system with the MSP, and through it, the Sydney distribution system.

21 The jointly constructed Interconnect is now owned by GasNet between Barnawartha and Culcairn NSW (a distance of approximately 62 km), and by EAPL between Culcairn and Wagga (a distance of approximately 89 km). The Interconnect is able to provide northern or southern gas flows thereby enabling customers in both NSW and Victoria actually and potentially to enjoy a competing source of gas. The Interconnect first carried gas from the Cooper Basin to Victoria during the Longford crisis in September 1998, and it first carried gas northbound to NSW during the Moomba gas production facility failure in August 1999.

22 The Interconnect has capacity constraints. The level of these constraints is one of the issues between the parties. A further issue is whether and to what extent the Interconnect places any significant constraints on anti-competitive behaviour by EGP. The Interconnect cannot transport gas to many places along the route of the EGP, including most points on the route of the EGP south of the ACT.

Eastern Gas Pipeline

23 Construction of the EGP commenced in August 1999, and was completed in September 2000 at a cost of about $497 million. The EGP is 792 km long, extending from Longford to Horsley Park via Cooma and Wollongong. Gas can now be supplied to the Sydney region from Cooper Basin via the MSP, or the Gippsland Basin via the EGP or the Interconnect. A lateral pipeline from the EGP to Canberra is under construction and is expected to be in operation in early 2001. The EGP serves a number of regional centres which are not served by the existing MSP or its associated laterals, such as Bombala, Cooma and Bairnsdale.

24 For part of its length (Wilton to Horsley Park), the EGP runs parallel to the AGL pipeline to Horsley Park. AGL and Duke were unable to agree to the interconnection of the EGP with AGL's transmission link at Mt Keira, hence Duke duplicated the AGL facility.

25 The EGP is the subject of foundation contracts with ESSO/BHP which take up less than the pipeline's existing or ultimate capacity. It is the applicants' case that the EGP is an open access pipeline offering a range of gas transmission services on a non-discriminatory basis. The operator has every incentive to secure contracts for the provision of those services and has published tariffs based on the price negotiated with the Gippsland producers and reflected in the foundation contracts. Those tariffs are available to all customers, regardless of the volume of gas they wish to transport.

26 It is common ground that at no time has any company within the AGL group sought access to the EGP, nor has AGL been denied access to the EGP. Nor is there any evidence of denial of access to the EGP to any other person seeking such access.

Duke's marketing associate

27 Duke Energy Australia Trading and Marketing Pty Ltd ("DEATM") is a wholly owned subsidiary of Duke Energy Australian Holdings Pty Ltd (as is the operator of the EGP, Duke Australia Operations Pty Ltd). The ultimate parent of all corporations within the Duke group is Duke Energy Corporation.

28 DEATM is a wholesaler and aggregator of energy services, both gas and electricity. It commenced commercial operations late in 1998. DEATM purchases gas, makes arrangements for the transport of gas, and sells delivered gas to its customers, who are mainly gas retailers, but include some large industrial users.

29 At the time it commenced operation, DEATM was the first new wholesale aggregator to offer bundled gas supply and transport services to the new retailers of gas in the Sydney region. Its only competitor in the supply of bundled services to retailers has been, and is, AGL Wholesale Gas Ltd (`AGLWG"). At that time AGL and its related corporations dominated the NSW gas market.

30 Between September and October 1999 DEATM entered into gas sales contracts with Citipower, Energy Australia and Integral Energy. These companies are large energy retailers, which were assessed by DEATM as having the potential to achieve competition in the supply of gas to end users in the Sydney region.

31 On 1 October 1999 DEATM entered into a contract with the Gippsland Basin Producers for the purchase of gas `ex Longford', and also gas transport agreements for the delivery of gas via the Interconnect to the city gate at Wilton. On 1 October 1999 DEATM also entered into a contract (effective 1 October 2000) with the Gippsland Basin producers for gas delivered to NSW via the EGP. On 30 June 2000 DEATM entered into a contract with EGP for transport of Gippsland Basin gas to the Sydney region distribution system. At that time EGP's charges were less than the price charged for transmission from Longford via the Interconnect, or from Moomba via the MSP.

32 According to the evidence of Mr Myatt, which the Tribunal accepts, DEATM's commercial strategy is "to develop a diversified portfolio by obtaining gas from multiple sources and delivering it via multiple transportation routes".

33 The evidence presented to the Tribunal, which it also accepts, is that DEATM has no role to play in the management of the companies which own and operate the EGP. The operator of the EGP is also the operator of the Queensland Gas Pipeline, which has for many years been subject to the access provisions and "ring fencing" requirements established under the Queensland legislation similar to those established under the Code.

34 Duke Operations is physically separated from DEATM in the conduct of its business and employs different personnel. There is evidence from a number of witnesses that there is no agreement, arrangement or understanding between Duke Operations and DEATM to favour DEATM in relation to the securing of contracts for transportation of gas to the EGP. There is also evidence that Duke follows a set of procedures, and trains its staff so as to ensure that there is "ring fencing", albeit it has not produced a manual on that topic. The Tribunal generally accepts this evidence.

35 In September 2000 the DEATM contract of June 2000 was amended so as to make more favourable provision in relation to charges for authorised overruns than had previously been the case, in that the first 50% of authorised overruns did not attract a surcharge. Duke did not notify this change on its website. There was some evidence that the standard terms and conditions had been changed to reflect the amendment, and there was some evidence that similar terms would be offered to other enquirers.

36 There was also evidence that companies within the AGL group are the subject of an enquiry by IPART in relation to allegations that on sixty eight occasions AGL infringed the "ring fencing" provisions of the NSW legislation relating to entry into contracts with associated persons.

37 Whilst the Tribunal accepts, to use the words of Mr McDanold, that EGP's current philosophy is that it wants to

encourage third party access, and that its commercial interests lie in selling capacity, rather than in restricting its sale, the Tribunal recognises that EGP's perception of where its commercial interests lie may change, and that the practical efficacy of "ring fencing" arrangements depends upon management's determination to enforce them.

The Statutory Criteria

38 Section 1.13 of the Code provides that the Relevant Minister must decide that the pipeline is covered if the Relevant Minister is satisfied of all of the matters set out in pars (a) to (d) of s 1.9, but the Relevant Minister must decide that the pipeline is not covered if not satisfied of one or more of those matters.

39 The matters specified in s 1.9 are as follows:

> *"(a) That access (or increased access) to Services provided by means of the Pipeline would promote competition in at least one market (whether or not in Australia), other than the market for the Services provided by means of the Pipeline;*
>
> *(b)* that it would be uneconomic for anyone to develop another Pipeline to provide the Services provided by means of the Pipeline;
>
> *(c)* that access (or increased access) to the Services provided by means of the Pipeline can be provided without undue risk to human health or safety; and
>
> *(d)* that access (or increased access) to the Services provided by means of the Pipeline would not be contrary to the public interest."

40 "Service" is defined so as to mean, relevantly, a service provided by means of a Pipeline including (without limitation):

> *"(a) haulage services (such as firm haulage, interruptible haulage, spot haulage and backhaul);*
>
> *(b)* the right to interconnect with the Pipeline; and
>
> *(c)* services ancillary to the provision of such services,

but does not include the production, sale or purchasing of Natural Gas."

NCC Recommendation

41 On 8 May 2000, NCC issued its Draft Recommendation in which it expressed itself as satisfied as to criterion (b), (c) and (d) in s 1.9 of the Code but said in relation to criterion (a) that on the information available it was difficult to determine whether access (or increased access) to the whole EGP would promote competition in the market for the sale of gas in south-east Australia. NCC said that it considered that there was "the prospect that the [EGP] will behave in a competitive manner, pursuing market share and maximising gas throughput, especially in the short to medium term" (at 11). The draft concluded that there were two possible approaches to criterion (a). One was to recommend against coverage at and north of the off-take to the ACT region because NCC was not satisfied that access (or increased access) would promote competition, and adopt a wait and see approach and ascertain whether effective competition in the downstream gas markets developed. NCC stated that it would give further consideration to that possible recommendation. The likely alternative was for NCC to recommend coverage of the whole of the EGP.

42 By the time of its Final Recommendation, NCC had come to the conclusion that all four criteria in s 1.9 of the Code were met in respect of the whole of the EGP, but NCC did not expressly state the reasons which caused it to select the second of the alternative possible approaches in relation to criterion (a) identified in the draft, in preference to the first.

The General Nature of the Case

43 The applicants' case is that coverage should not apply because:

(a) coverage of a pipeline under the Code is designed and adapted to bring about improved access and terms of access for those pipelines which, because of their (natural) monopoly characteristics, are unlikely to offer access on terms that will promote upstream or downstream competition;

(b) open access is already provided to the EGP on non-discriminatory terms and conditions;

(c) the EGP has already prompted a competitive response from other pipelines delivering gas to Sydney and other locations served by the EGP. This demonstrates that these pipelines see themselves in competition with EGP; they therefore provide the same services as EGP; and

(d) in these circumstances the EGP is not a pipeline (at least for the foreseeable future) appropriate to be Covered, and in particular the tests for coverage are not satisfied in relation to the EGP.

44 In short, coverage would substitute regulation for the market, when the market has been shown to be exercising effective discipline over market power and, as the Tribunal said in *Re: Review of Freight Handling Services at Sydney International Airport* (2000) ATPR¶41-754 ("*Sydney International Airport*"), regulatory controls designed to mimic the operation of a free marketplace are a "second best" to the outcomes produced by actual competition. The contrary point of view is that the EGP is a natural monopoly which operates as a bottleneck to competition in relation to the downstream gas sales markets by reason of the market power which it is able to exercise.

The Role of the Tribunal

45 The Tribunal invited the applicants to present their evidence first, because the Tribunal considered that to proceed in that way was more conducive to the expeditious resolution of the problem than other available options. Whilst there was debate from time to time as to who should go first, and what the consequences might be if the applicants declined to call any evidence, ultimately these procedural problems faded into the background because, for purely pragmatic reasons, the applicants acceded to the Tribunal's request that they should present their materials first.

46 At the end of the day it was common ground that the Tribunal was bound to reach its own conclusion on the application of the statutory criteria to the facts upon the basis of the Tribunal's assessment of the material which is before it. The result is that unless the Tribunal is affirmatively satisfied as to each of the matters set forth in pars (a) to (d) of s 1.9 of the Code, the Tribunal must set aside the Minister's decision. The Tribunal, like the Minister, has NCC's coverage recommendation before it (the Tribunal reviews the Minister's decision, not the coverage recommendation), but the Tribunal is no more bound by that recommendation than was the Minister.

47 The Minister appeared by counsel at the first directions hearing of the proceedings before the Tribunal, but elected to play no role in the proceedings thereafter. The role of contradictor in relation to the case put by Duke was adopted by NCC and AGL.

Access to "Essential Facilities"

48 The report by the Independent Committee of Inquiry into National Competition Policy published in August 1993 ("the Hilmer Report") included a chapter, chapter 11 titled "Access to `Essential Facilities'". In *Sydney International Airport*, the Tribunal indicated at 40,755 that any submission as to the policy underlying Part IIIA of the *Trade Practices Act* ("TPA"), based on the Hilmer Report, must be considered with caution, as the legal regime to enable access to essential facilities recommended by the Hilmer Committee was not implemented by Part IIIA. That observation is equally applicable to the use of the Hilmer Report in relation to the *Gas Pipelines Access Law*.

49 Nonetheless, the Hilmer Report provides some useful background. The Hilmer Report recommended that a right of access to a facility should only be created if (*inter alia*) access to the facility in question is essential to permit

effective competition in a downstream or upstream market. That recommendation was based upon the proposition that:

> *"In some markets the introduction of effective competition requires competitors to have access to facilities which exhibit natural monopoly characteristics, and hence cannot be duplicated economically."* (at 239)

50 The authors of the Hilmer Report indicate that it is difficult to define precisely the term "natural monopoly", but cite major pipelines as an example. Some facilities that exhibit the characteristics of a natural monopoly occupy strategic positions in an industry, and are thus "essential facilities" in the sense that access to the facility is required if a business is to be able to compete effectively in upstream or downstream markets.

51 Reference was made by the authors of the Hilmer Report to the "essential facility" doctrine developed by the courts in the USA on the basis of s 2 of the *Sherman Anti-Trust Act* 1890 (USA). One statement of the principles involved in that doctrine requires:

(1) control of the essential facility by a monopolist;

(2) a competitor's inability practically or reasonably to duplicate the essential facility;

(3) the denial of the use of the facility to a competitor; and

(4) the feasibility of providing the facility.

52 The Competition Principles Agreement entered into by the Commonwealth of Australia and the governments of the various States and Territories in Australia on 11 April 1995 recited that the Council of Australian Governments ("COAG"), at its meeting on 25 February 1994, agreed to the principles of competition policy articulated in the Hilmer Report. By that agreement the Commonwealth agreed to put forward legislation to establish a regime for third party access to services provided by means of significant infrastructure facilities in circumstances where:

(a) it would not be economically feasible to duplicate the facility;

(b) access to the service is necessary in order to permit effective competition in a downstream or upstream market;

(c) the facility is of national significance having regard to the size of the facility, its importance to constitutional trade or commerce or its importance to the national economy; and

(d) the safe use of the facility by the person seeking access can be ensured at an economically feasible cost, and if there is a safety requirement, appropriate regulatory arrangements exist.

Pursuant to that agreement, the Commonwealth passed the *Competition Policy Reform Act 1995* (Cth) which, *inter alia*, enacted Part IIIA of the TPA.

53 On 7 November 1997 the Commonwealth, the States and the Territories entered into the *Natural Gas Pipelines Access Agreement*. The objective of that agreement was to establish a uniform national framework for third party access to natural gas pipelines that would:

(a) facilitate the development and operation of a national market for natural gas;

(b) prevent abuse of monopoly power;

(c) promote a competitive market for natural gas in which customers would be able to choose suppliers, including producers, retailers and traders;

(d) provide rights of access to natural gas pipelines on conditions that are fair and reasonable for both the Service Providers and Users; and

(e) provide for resolution of disputes.

54 The *Gas Pipelines Access Law* was enacted pursuant to that agreement, and the preamble to the Law substantially reproduces the access objectives referred to in that agreement.

Some issues of construction

"To develop another pipeline"

55 A literal construction of criterion (b) might require the decision-maker, in the application of the criterion, to ignore the existence of pipelines which have already been developed. That is not the approach adopted by NCC in its Final Recommendation. NCC said at 47:

> *"... the Council considers the objectives of the legislative scheme are best met by also having regard to the provision of competing services by another existing pipeline for the purposes of criterion (b).*
>
> ...
>
> *The Council concludes that where an existing pipeline already provides, or could provide with minor modifications or enhancements, services which are competitive with the services of the pipeline the subject of the coverage application, criterion (b) will not be satisfied."*

NCC took into account whether the MSP or the Interconnect do or could provide competing services to the services provided by means of the EGP, whether or not this required some enhancement to the existing capacity of those other pipelines.

56 No one contended that the Tribunal ought to adopt a different approach from that adopted by NCC in this respect. The expert economist called by the applicants, Mr Ergas, could think of no economic reasoning that would support a finding that pipelines that are actually duplicated deserve to be covered under the Code by virtue of criterion (b), unless for some reason the duplicated pipelines are not acceptable substitutes for each other.

57 There is no logic in excluding the existing pipelines from consideration in the determination of whether criterion (b) is satisfied. The policy underlying the Code would not be advanced if the Tribunal were to proceed in that blinkered way. We therefore think it appropriate to enquire whether the MSP or the Interconnect provide or could be developed to provide the services provided by means of the EGP. The proper characterisation of those services is itself an issue of construction which is addressed later.

"Uneconomic"

58 In *Sydney International Airport* the Tribunal gave attention to the meaning of "uneconomical", where used in the TPA equivalent of criterion (b). Criterion (b) is expressed in terms of whether it would be "uneconomic" (as opposed to "uneconomical") to develop another Pipeline (as opposed to another "Facility"), but at least in the present context, nothing turns upon this difference in language.

59 The Tribunal said in that case that in deciding whether it is "uneconomic" for a person other than the provider of the existing pipeline to develop another pipeline, the enquiry is not limited to a narrow accounting view of "uneconomic", or simply issues of profitability. Rather, "uneconomic" is to be construed in a broader social cost benefit sense, in which the total costs and benefits of developing another facility are brought to account. The Tribunal said that its preferred view was given added weight by economic evidence given in that case as to the perverse impact, in terms of efficient resource allocation, of adopting the narrower view.

60 The Hilmer Report suggests that criterion (b) was intended to describe a pipeline which exhibits "natural monopoly characteristics". Whilst there is disagreement between the expert economists in the present case as to what constitutes a natural monopoly, the view expressed by NCC in its Final Recommendation (at 42) is that where

a single facility can meet market demand at less cost than two or more facilities, then the facility exhibits "natural monopoly" characteristics.

61 That suggests that if a single pipeline can meet market demand at less cost than two or more pipelines, it would be "uneconomic" to develop another pipeline to provide the same services, because those services are most efficiently provided by the existing pipeline.

62 Thus, Posner in *Natural Monopoly and its Regulation (30th edition, 1999)* states at 1:

> *"If the entire demand within a relevant market can be satisfied at lowest cost by one firm rather than by two or more, the market is a natural monopoly, whatever the actual number of firms in it. If such a market contains more than one firm, either the firms will quickly shake down to one through mergers or failures, or production will continue to consume more resources than necessary. In the first case competition is shortlived and in the second it produces inefficient results. Competition is thus not a viable regulatory mechanism under conditions of natural monopoly."*

In *The National Access Regime: A Draft Guide to Part IIIA of the* [Trade Practices Act], *(August 1996)* NCC pointed out that natural monopoly occurs where one facility can supply the entire market demand more cheaply than two or more smaller facilities:

> *"Clearly, rather than making a competitor build a second network to compete with the existing network, it would make more economic sense in such situations to give the competitor access to the existing network."* (at 22)

Natural monopolies often require big upfront investments in infrastructure, but their operating costs are relatively small, and vary little as more of the infrastructure's capacity is brought on line.

63 In his evidence, Mr Ergas accepted that one of the objectives underlying criterion (b) was the avoidance of socially undesirable outcomes. He did not disagree with the approach enunciated by the Tribunal in *Sydney International Airport*. However, he made the point that to an economist, "efficiency" has three dimensions. There is productive efficiency, allocative efficiency and dynamic efficiency. Productive efficiency is production at least cost. Allocative efficiency occurs when services are provided to those who value them most highly. Dynamic efficiency involves preserving incentives for innovation and investment. On the basis of many studies and long experience, economists have concluded that the main virtue of competition is that it provides a very powerful means of securing important gains in allocative and especially dynamic efficiency.

64 Thus we accept that if a single pipeline can meet market demand at less cost (after taking into account productive allocative and dynamic effects) than two or more pipelines, it would be "uneconomic", in terms of criterion (b), to develop another pipeline to provide the same services. NCC submitted that one of the objectives of the code is to deter and render unnecessary inefficient duplication. If this is so, the Code does not contain any mechanism for the achievement of this objective, because it is a matter for a pipeline owner to decide whether or not to construct an "inefficient" pipeline. Generally speaking, owners act on private cost, rather than social cost considerations. If development of a competitive pipeline is economic in a private cost sense, and is driven by opportunities in the market, then this may have implications for the assessment of criterion (a).

"The Services provided by means of the Pipeline"

65 The starting point for the application of the coverage criteria is the identification of the "services provided by means of the pipeline". As earlier noted, the Code contains an inclusive definition of "service", which encompasses haulage services as well as the right to interconnect with the pipeline and services ancillary to the provision of those services. For present purposes it is sufficient to concentrate on haulage services which, whether in terms of forward haul or backhaul, are the most significant of the services provided by the pipeline.

66 The EGP enables the transport of gas from Longford to Sydney, and to various locations along the route. The services provided by the EGP are provided in a number of local transport markets, namely:

- the origin market (which is also served by GasNet/the Interconnect);

- the destination markets, which include all locations in which EGP has installed, or plans to install, off-takes to deliver gas to customers. (The Sydney and Canberra destination markets are also served by GasNet/Interconnect and by the MSP.)

67 Mr Ergas proposes that the services provided by the EGP cannot be described independently of the markets for the provision of those services, and, at a broad level, the services provided by means of the EGP are:

- delivery of natural gas to Sydney and Canberra;

- delivery of natural gas to Bombala and Cooma;

- delivery of natural gas from Longford;

- delivery of natural gas from new fields that may potentially be developed in the future.

On the other hand, Dr Makholm, the economist called by NCC, described the service which the pipeline provides as a point to point service, regardless of the substitution possibilities which might exist at either end of the pipeline. In his view, the identification of the services provided by the pipeline arises independently of any analysis of the market or markets within which those services might be provided.

68 The pipeline operator sells a (haulage) service consisting of the transport of gas from point A to point B. That is what the customer buys. EGP's standard contract describes the service to be provided as a firm forward haulage service involving the transport of natural gas in the pipeline between specified receipt points and delivery points. The backhaul haulage service contract describes the service to be provided in the same way, but via a displacement service.

69 The question of what constitutes the services provided by the pipeline is fundamentally a mixed question of fact and the proper construction of criterion (b), rather than a matter of economic analysis. Every haulage service will of necessity be from one point to another. That is the commercial service actually provided by the pipeline operator to its customers. That service may be of different use to the producers in the origin market or to the customers in the destination market, but it is the same service. No market analysis is necessary or appropriate in the description of the services provided by the pipeline. However, questions of market definition and market power do arise in the context of criterion (a).

70 NCC, in its Final Recommendation, noted that there were two possible approaches to the definition of the relevant services, namely identification of the services with respect to the markets they serve, or definition of the services in terms of both the start and end points of the service. NCC said that it preferred the second approach, for a number of reasons which it gave. We have come to the same conclusion, but because of the view which we take as to the proper construction of criterion (b). We should, however, add that the Code contemplates (for example in s 1.13) that coverage may occur in relation to part of a pipeline, which lends some slight support to the proposition that a haulage service is appropriately defined on a point to point basis, rather than by reference to the market/s which it serves.

"Access"

71 Duke contends that the criteria proceed on the premise that access to the services provided by means of the pipeline is either unavailable or limited. An example of limited access is provided by *Sydney International Airport*, where access was limited to four ramp handlers selected through a tender process. Duke contends that the EGP, however, is an open access pipeline: all users or potential users of services provided by means of the pipeline have access to those services, in the sense that third parties have the opportunity to avail themselves of those services if they wish to do so. In Duke's submission, one does not get to the question of whether access or increased access to the pipeline services would have a pro-competitive effect in other markets unless, as a matter of fact, access to the

pipeline services is either unavailable or restricted. As access to the EGP is already available, and not restricted, criterion (a) is not satisfied.

72 In the event that the Tribunal did not accept its submission, Duke also presented evidence and argument in accordance with the view that access means coverage. That was also the position adopted by NCC. AGL submitted that access means access in fact which is legally secured; invitations to treat and offers do not result in access. Under this view, any offer of access, whether under coverage or not, would not be access in terms of the s 1.9 criterion until a contract had been signed. On this view it would be only rarely that criterion (a) would not be satisfied.

73 An object of the Code, according to (d) of the introduction to it, is to provide **rights of access** to natural gas pipelines on conditions that are fair and reasonable to the providers of the pipeline services, and to persons wishing to use them. The Code adopts a two stage process to access regulation. The first stage consists of the Ministerial decision that the pipeline is covered or not covered. The second stage consists of the fixing of Access Arrangements which, in general, are not to displace the contractual rights of other persons already using the pipeline. If a dispute arises as to the application of the Access Arrangements, then there is provision for an arbitrated outcome. There is nothing to prevent parties from reaching a commercial agreement as to access outside the terms of any approved Access Arrangement. The aim of the Code, according to the introduction which prefaces it, is:

> *"To provide sufficient prescription so as to reduce substantially the number of likely arbitrations, while at the same time incorporating enough flexibility for the parties to negotiate contracts within an appropriate framework."*

74 The object of the Code, and its structure, make it clear that criterion (a) does not have as its focus a factual question as to whether access to the pipeline services is available or restricted. Put in that way, the question would not take sufficient account of the terms on which access is offered. Rather, the question posed by criterion (a) is whether the creation of the right of access for which the Code provides would promote competition in another market. The enquiry is as to the future with coverage and without coverage. We agree with the approach adopted by the Tribunal in *Sydney International Airport* in this respect. The Tribunal must have regard to the position as it now stands, insofar as it provides a reliable guide to the future without coverage. Thus, (assuming the present is a reliable guide to the future without) account is to be taken of the EGP as an open access pipeline, and of any other pipelines supplying the upstream or downstream gas markets, in order to determine whether coverage of the EGP would promote competition in at least one of those markets.

"Promote competition"

75 The meaning of this term was discussed by the Tribunal in *Sydney International Airport*. The Tribunal said (at 40,775) that the notion of "promoting" competition:

> *"involves the idea of creating the conditions or environment for improving competition from what it would be otherwise. That is to say, the opportunities and environment for competition given declaration, will be better than they would be without declaration."*

The Tribunal concluded that the TPA analogue of criterion (a) is concerned with the removal of barriers to entry which inhibit the opportunity for competition in the relevant downstream market. It is in this sense that the notion of promotion of competition involves a consideration that if the conditions or environment for improving competition are enhanced, then there is a likelihood of increased competition that is not trivial. We agree.

Markets

76 Market definitions are required for the application of criterion (a). In particular, the market in which the gas transmission services are provided and the market in which the services may promote competition must be defined. All the evidence supported the definition of a market as concluded in *Re Queensland Co-Operative Milling Association Ltd* (1976) 25 FLR 169 at 190:

> *"A market is the area of close competition between firms or, putting it a little differently, the field of rivalry between them (if there is no close competition there is of course a monopolistic market). Within the bounds of a market there is substitution - substitution between one product and another, and between one source of supply and another, in response to changing prices. So a market is the field of actual and potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive. ... Whether such substitution is feasible or likely depends [on a number of factors] ... in determining the outer boundaries of the market we ask a quite simple but fundamental question: If the firm were to `give less and charge more' would there be, to put the matter colloquially, much of a reaction?"*

77 There were virtually no differences in the submissions and economic evidence about the definition of the two relevant markets, which drew on the Tribunal's market determination in *AGL Cooper Basin Natural Gas Supply Arrangements* (1997) ATPR¶41-593 to some extent. It was agreed that the product of concern is mainly gas as there is little competition between energy sources at this time. It was agreed that gas transmission services are provided in the gas transmission market which is functionally separate from other parts of the gas market. Other functional areas are exploration, production/processing, sales and distribution/reticulation. NCC and Dr Makholm identified gas production/process and sales as markets where competition may be promoted by the services of the EGP. Mr Ergas considered that competition may also be promoted in the gas exploration market. It was agreed that the geographic scope of the market is South East Australia. There was a slight difference in the economic evidence on the geographic scope of the South East Australia market but it was agreed that the difference was not material to the assessment of criterion (a).

78 None of the material before the Tribunal was explicit on the time dimension of the market. NCC stated that it used a long run view but did not explain what that meant or how it affected its analysis of criterion (a) (except perhaps its conclusion that installed pipeline capacity is likely to be absorbed between 2005 and 2010 (Final Recommendation at 39). Neither Dr Makholm nor Mr Ergas mentioned the time dimension of the other market. In *AGL Cooper Basin Natural Gas Supply Arrangements* (supra) at 44,210, the Tribunal specified a period of "perhaps ten or fifteen years" as the future market. This period appears to be sufficient in this case given the uncertainties surrounding the operation of a competitive market and forecasts of demand, the existence of spare capacity and significant long term contracts which expire in 2006, and the time to develop new pipelines and new gas fields.

79 Estimates of price elasticities are the main evidence used to argue that gas and electricity are provided in separate markets. The available evidence indicates that the price elasticity of demand for gas is low, and that gas prices have little influence on the demand for electricity (cross price elasticity). The elasticities were estimated using data which pre-dates the reforms in the gas industry so they are likely to be underestimates of the actual position today. In the future, changes in technology and the use of gas to generate electricity from 2006 onwards could be expected to lead to a more integrated energy market.

80 The Tribunal concludes that for criterion (a) to be met, access or increased access to the EGP should promote competition over the next ten to fifteen years:

- in a downstream market, being the sale of gas to users in South East Australia; and/or

- in an upstream market, being the production of gas which would imply competition between the Cooper Basin and Gippsland Basin producers.

Criterion (a): "That access (or increased access) to services provided by means of the Pipeline would promote competition in at least one market (whether or not in Australia), other than the market for the services provided by means of the Pipeline".

81 In considering the application of criterion (a) to the facts of this case, it is not disputed that the construction and commissioning of the EGP has resulted in a not insignificant level of competition at the wholesale and retail levels for the sale of gas in NSW. Nor is it disputed that the construction of the EGP produced at least the environment

for basin on basin competition. In and of itself, the construction and commissioning of the EGP has been pro-competitive.

82 The competition between the pipelines serving the Sydney market has had flow-on effects into the market for gas in Sydney. This flow-on occurs because it is the delivered price of gas, comprising the wellhead price and the transmission charge, which determines the price of gas. The competition was evident in two ways. First, there was a reduction in the price of gas transmission services on the MSP in response to the (then) proposed opening of the EGP. There was also a price decrease on the AGLGN pipeline which connects to the MSP at Wilton, although there was disagreement about whether this resulted mainly from the proposed entry of EGP or the actions of the NSW regulator. Second, there were changes in the supply of gas between the Cooper and Gippsland Basins, with the latter now supplying a significant amount of gas into NSW which previously came from the Cooper Basin. The indirect effect of the fall in demand for Cooper Basin gas in NSW is that gas from that basin is now being sold into Victoria and being transported along the Interconnect. The pipeline and basin competition has also been associated with a reduction in the price of using the Interconnect through discounting of the reference tariff.

83 Nevertheless the question for the Tribunal is whether the opportunities and environment for competition in market(s) upstream or downstream of the EGP would be enhanced if the EGP were to be covered in terms of the Code, than if it were not. Separate consideration needs to be given to the position in regional centres south of the ACT as these areas are not served, and are not likely to be served, by a pipeline other than the EGP. NCC's approach in its Final Recommendation to the scope of the enquiry required by criterion (a) does not differ in any material respect from that adopted by the Tribunal.

NCC position summarised

84 In its Final Recommendation, NCC recognised that the fact that Duke has no interest in gas production or distribution services, and only limited interest in gas sales, combined with the expectation that there will be some surplus transmission capacity into Sydney, "militate against the contention that EGP's power in the transmission services market will restrict competition in the South East Australian gas sales market" (Final Recommendation at 13).

85 Nonetheless, NCC concluded that there is a real danger or likelihood of parallel pricing behaviour between EGP and MSP, and for that reason coverage was more likely to promote the conditions for greater competition in the South East Australian gas sales market than would otherwise be the case.

86 The substantial reason which NCC gave for reaching that conclusion was that in a market where there are effectively only two competitors (EGP and MSP), and a low risk of entry by a third party, there is "the prospect" that EGP "may be able to execute a strategy of pricing capacity above competitive levels" in anticipation that MSP would follow suit. Successful execution of a strategy to that effect would result in a less than competitive market, and greater profits for both pipelines.

87 NCC identified features of the market place which, in its view, would assist this strategy:

- EGP's investment in the pipeline is sunk; it cannot be forced out of the market, making accommodation more likely;

- the ability of MSP to respond in the short to medium term will be constrained by its available capacity (unless increased) and pre-existing contractual commitments at established tariffs;

- the disparity between current prices (which are near average costs) and marginal costs suggests that the consequences for either pipeline of a price war, where price is driven towards marginal cost, would be disastrous;

- monitoring by either party would be relatively easy;

- EGP and MSP will have significant bargaining power in negotiations with producers and gas users;

- a gas retailer wishing to switch from one pipeline to another would face the necessity of also switching sources of gas supply from Moomba to Longford or vice versa. These contractual complexities may make it more difficult for one pipeline to suddenly drop its price and rapidly pick up market share;

- pipeline customers are likely to shop around for the best price, and would in the process of so doing keep each pipeline operator informed of the pricing being offered by its competitor.

88 NCC concluded that the market is one in which there were only two competitors because the Interconnect has little capacity to compete with the EGP in view of the costs of upgrading it sufficiently. NCC found that there is little risk in the short to medium term of entry by another pipeline, because of the relatively slow market growth in NSW, and the possibility of expanding capacity in the EGP up to 120 PJ per year, and in the MSP up to 210 PJ per year, at costs much lower than building a pipeline into NSW.

89 In its submission to the Tribunal, NCC elaborated on these contentions. It was put that:

- the EGP will rapidly grow in importance to gas sales to regions in NSW/ACT as Bass Strait gas producers will increasingly want to sell gas into NSW/ACT, because that is where sales are growing, and NSW/ACT gas consumers will increasingly want to buy gas from Bass Strait producers because of likely greater availability (than Cooper Basin gas) and lower prices;

- demand for gas is generally price inelastic, increasing opportunities for rent seeking behaviour in the gas sales market because the EGP is a bottleneck between Bass Strait producers and NSW/ACT consumers; these gas transactions drive demand for EGP services (ie demand for EGP services is a derived demand) and because the cost of gas transportation services is a small proportion of the costs of delivered gas, there are large profits available to Duke from restricting competition and exploiting market power in the gas sales market.

90 NCC also submitted that EGP was faced with the following economic incentives which were germane to the assessment of the market conditions absent coverage:

- EGP has the ability to set prices above competitive rates. EGP will be able to set prices above costs by a very substantial margin without a substantial fall in sales (or output) of pipeline services;

- EGP would have or could potentially have, privileged access to information concerning competitors of its marketing associate that would enable it to discriminate and effectively create a barrier to the entry of competing gas suppliers or marketeers;

- EGP would have the incentive to sign a transportation contract with its marketing associate that would give that associate preferential access to tariff discounts, terms and conditions, operational information etc;

- EGP would have the incentive to create very tight (or excessively tight) operational rules that would also allow it to grant concessions by way of discriminating amongst customers simply for the purpose of extracting monopoly rents. Such restrictions could include:

(1) transport customers constrained to even hourly takes;

(2) high over-run and imbalance charges;

(3) long notice periods for changes in nominations; scheduling, etc; and

(4) restrictions on changes in contracts or between delivery points, etc.

- EGP would have the incentive to view new interconnections and requests for taps into its pipeline not with regard to economic efficiency in transport or competition in the gas market, but from the prospects for its owners or its associate's profits.

AGL's position summarised

91 A summary of AGL's position, at the general factual level, is that:

- there are serious problems with the economic deliverability over the coming years of reserves from the Cooper Basin which will compel gas purchasers, including AGL, to purchase significant quantities of gas from the Bass Strait;

- most additional gas flowing from Bass Strait to Sydney is likely to come via the EGP. No new pipeline will be built. The Interconnect has limited capacity and is unlikely to be expanded;

- EGP is, and is likely to remain, the monopoly supplier for transport of all but minimal quantities of gas from the Gippsland Basin to the NSW/ACT market;

- the MSP only provides a limited competitive restraint on pricing or anti-competitive conduct by EGP absent coverage;

- competition at the margin may impose a degree of competitive restraint on price, but it does not force pricing at an efficient level. There are insufficient competing pipelines to produce effective competition for transport services. Duke has not shown that its initial reference tariff of 86c/GJ reflects or is intended to reflect the price charged in a market showing efficient competition. See Code: 8.1(a) and (b);

- backhauls and swaps are largely a thing of the future and do not form a sound basis for conclusions about the state of competition or likely competition in the market;

- Duke's claim that it offers non-discriminatory access to all (new) comers breaks down on the evidence as does its claim that voluntary ring fencing matches what the Code would require.

Demand and Capacity

92 The continued existence of spare pipeline capacity is one factor which may encourage competition between the pipelines. The existence of spare capacity is dependent on the demand for gas and on whether the existing capacity of the pipelines is expanded as demand increases. In its Final Recommendation, NCC concluded that the installed capacity of the MSP and EGP is likely to be absorbed between 2005 and 2010 (at 39), based on constraints on peak seasonal capacity in about 2005 and annual physical pipeline capacity in about 2010. This conclusion requires examination, as both the demand forecasts and the existing EGP capacity provided in evidence to the Tribunal were lower than those used by NCC. The Interconnect capacity was not included in NCC's calculations at all. In addition, the Tribunal was presented with evidence that capacity could be increased on all three pipelines at costs below the current tariffs, particularly on the EGP and MSP.

93 Several sets of forecasts of the demand for gas have been produced and, at the request of the Tribunal, NCC compiled an extensive list of forecasts of NSW/ACT demand (containing both published and confidential data submitted to the Tribunal). Analysis of this data indicated that the forecasts of EAPL and Duke are significantly lower (at least 40 PJ/year in the early part of the decade decreasing to between zero and 20 PJ/year by 2014) than the forecasts relied on by NCC. The ACCC Draft Decision on the MSP tariffs showed similar discrepancies between forecasts, but the EAPL forecasts were accepted as "best estimates" by ACCC to set tariffs. The significant differences in the forecasts, especially in the early years, can largely be attributed to the assumptions made on the use of gas for electricity generation. The forecasts produced by EAPL and used by ACCC assume that gas will not be used to generate electricity until at least 2005 due to excess capacity in electricity generation in NSW and Victoria. The forecasts show NSW/ACT demand for gas increasing from 110 PJ in 2000 to 211 PJ in 2014. This represents an increase of 93 per cent over 14 years or an average increase of 4.8 per cent per annum. Below average increases in demand are forecast to occur up to 2005 and after 2010, and above average increases in the intervening years. These differences reflect the timing of growth in the use of gas for electricity generation.

94 The definition of capacity is complex, as the way a pipeline is operated can affect its capacity. For example,

pressure where the gas enters the pipeline, compressor utilisation, and daily/weekly profile of loads can all affect pipeline capacity. The market transactions of backhauls and swaps mean that gas quantities can exceed physical capacity with no expenditure. Although there are currently limited backhaul, and no swap, transactions, the potential is there for capacity to be increased as a result of those transactions as competition develops in the gas market. Despite the complexity in defining capacity, estimates are presented below to give some indication of the existence of spare capacity under certain conditions.

95 The Tribunal firstly examined when peak demand may exceed installed capacity using the method in the statement of Mr Rochford and capacities of 470 TJ/day for the MSP, 120 TJ/day for the EGP and 17.6 TJ/day for the Interconnect. AGL submitted that the method used by Mr Rochford for calculating spare capacity was not in accordance with the definition in the Code, so his estimates of spare capacity could not be used. That definition is concerned with the use of spare capacity when pipeline users do not use their contracted flow of gas; that is very different from forecasting aggregate demand, capacity and spare capacity for the purposes of determining whether competition may be facilitated. Our analysis indicates that there will be sufficient capacity to meet peak day demands at no cost until about 2006, and at a relatively low incremental cost after that date. Secondly, with respect to annual physical capacities of the pipelines, the EAPL demand forecasts suggest that the existing capacity of the three pipelines will not be exceeded until after 2014, the last year of the forecasts, and a date which is just within the time dimension of the market adopted by the Tribunal.

96 Those are the earliest dates when peak and annual capacities might be exceeded. The effect of backhaul and swap transactions in the gas market, and the ability to expand physical capacity mean that, as a practical matter, the dates when spare capacity will be exceeded will probably be later than those indicated. That backhaul transactions and capacity increases will occur is implied by the demand forecasts which include north and south gas flows over the Interconnect and gas to generate electricity.

97 The Tribunal's analysis also indicates that the MSP and the Interconnect between them could supply the whole of the expected NSW/ACT demand until about 2008, following relatively low cost capacity expansions.

98 Other assumptions used by EAPL in developing its forecasts are also relevant to determining whether competition between pipelines will continue. For example, the forecasts assume that within several years the EGP will be transporting 60 PJ/year; the Cooper/Eromanga Basin producers will be selling about 12 PJ/year into the Victorian market by 2005 as a competitive response to a loss of market share in NSW; new retailers in NSW and Victoria will enter the market with an impact on northbound Interconnect demands; the Interconnect will supply both the NSW/ACT and Victorian markets, with low northward flows in the early years (up to 2003) due to competition from the EGP but increases in later years (to 23 PJ/year of gas in 2012); and Moomba will become an important gas supply hub in the longer term to bring Papua New Guinea and Timor Sea gas into South East Australia as the Cooper Basin and Bass Strait fields are depleted. No indication of the timing of these longer term developments was given but recent reports indicate that Timor Sea gas could be delivered to Moomba by the middle of this decade.

99 The Tribunal concludes that spare pipeline capacity will continue to exist over the next 10 to 15 years, initially without the need to physically alter the pipelines and later with relatively low cost capacity increases or capacity increases as a result of the use of gas to generate electricity.

Reserves

100 It is one thing for the pipelines to have sufficient capacity to transport gas to meet NSW/ACT demands, but it is another to say whether there are sufficient supplies of gas to meet the demands. This is dependent on gas reserves and production in the basins served by the pipelines. The applicants contended that there are sufficient reserves in the Cooper/Eromanga Basin for the next 20 years. AGL contends that there are not, and that the cost of developing reserves means that the wellhead cost of gas from the Cooper Basin would be higher. Gas reserves in the Cooper/Eromanga Basin are lower than those in the Gippsland Basin and production from the Cooper Basin is expected to decline from the middle of the decade.

101 The availability of gas from Moomba cannot be of immediate concern because at least 20 PJ/year of NSW

demand has been transferred from the Cooper Basin producers to the Gippsland Basin through the EGP foundation contracts with Esso/BHP. In addition, the demand forecasts accepted by ACCC (described above) assumed that the Cooper/Eromanga Basin would supply 12 PJ/year to Victoria by 2005 and that the amount of gas supplied to Sydney would remain below current levels until about 2008.

102 In the medium to longer term the amount of gas which is supplied to the NSW/ACT market using the MSP is not expected to be dependent on the level of the Cooper/Eromanga Basin reserves alone. The offer document prepared by APL in March 2000 in connection with the float of APT forecast increased use of the MSP to 2010, based on gas from basins to the north of Australia using Moomba as a hub to sell gas into the NSW and Victorian markets. MSP throughput is shown as growing rapidly from 90 PJ/year in 2004 to 150 PJ/pear in 2010 (a 67% increase over 6 years). This suggests that any decline in production in the Cooper/Eromanga Basin can be countered by replacement with gas from other basins; this position is supported by the demand forecasts which assume that Moomba will become an important gas supply hub to bring Papua New Guinea and Timor Sea gas into South East Australia. In the offer document earlier referred to, APL directors say that there are substantial uncommitted reserves in Bonaparte Basin, Papua New Guinea and the North West (Carnarvon Basin); that the current hub at Moomba is an ideal focus for a transnational gas pipeline system; and that the MSP is well positioned to transport gas into NSW and Victoria from Moomba.

103 The Tribunal concludes that supplies of gas through Moomba are likely to be sufficient over the next 10 to 15 years as gas from the Cooper/Eromanga Basin will be supplemented by gas from basins to the north of Australia. There are reasonable grounds to expect that there will be sufficient gas supplies from and through Moomba to enable MSP to compete fully with EGP for gas sales to the NSW/ACT market over the next 10 to 15 years.

Contracts

104 Long term contracts are a feature of the gas industry, with producers wanting certainty that they will be able to recover their investments in extraction and production. It was argued that these contracts restrict the responses that purchasers of gas can make in response to price competition by pipelines. However, even when they are very long term (15 to 30 years), the contracts are not completely inflexible, eg the contracts can include price review clauses which are triggered by the price of other sources of gas. Long term contracts are not the only type of supply contract, and some evidence was given that contract periods with gas producers are becoming shorter (10 years) and there are short term contracts (5 years and less) in secondary and retail/wholesale markets. The contract between the Cooper Basin producers and AGL, the main user of the MSP, concludes in 2006 and negotiations have already commenced with producers. In response to the December 2000 ACCC Draft Decision on MSP tariffs (which suggested a reduction in the order of 40 per cent), Duke also indicated that it had commenced negotiations with the Gippsland producers for a reduction in the wellhead price of gas to enable gas from that basin to remain competitive with the gas from the Cooper Basin. When the Kipper field in Bass Strait comes on stream, expected in 2005, more competition will occur in the upstream market.

105 For the above reasons, the Tribunal does not believe that long term contracts will restrict competition to any great extent.

Elasticity of Demand

106 We accept that there is a low elasticity of demand for gas, and consequently for the transport of gas. But low elasticity of demand is mainly of relevance to pricing above competitive levels where a pipeline is a monopoly, ie faces the whole of the market demand, which is clearly not the case for the EGP. Where competition between pipelines exists, it is the cross price elasticities of demand between the different service providers which are relevant to the output of any one pipeline, not the elasticity of the market demand curve. The quantitative analysis of price increases by EGP undertaken by Mr Ergas ("SSNIP") implied a cross price elasticity of two between the EGP and the Interconnect; this was supported by evidence about the actual price sensitivity of gas purchasers in the marketplace. The "SSNIP" analysis tests substitutability by asking whether a firm would gain or lose by attempting to impose a small but significant, non-transitory increase in price on its own product or service.

107 A cross price elasticity of two is a high figure. It means that a 10 per cent increase in price will result in an increase in the demand for the alternative service(s) of 20 per cent.

108 NCC submitted that the SSNIP analysis was relevant to questions of market definition and competition effects, although it was not relevant to criterion (b) (at par 41-42 of its Final Submission). NCC and AGL queried the underlying assumptions of the analysis (par 55 and par 40 respectively), in particular the availability of gas from Moomba and whether the existing EGP tariff is at the level which would occur in a competitive market. We have concluded above that gas is likely to be available through Moomba. Mr Ergas said that if the EGP tariff was a monopoly price then there would be a greater risk that the analysis was incorrect but it would not be completely invalidated. The Tribunal is not convinced that these assumptions invalidate the analysis when taken together with the evidence of the competition currently occurring and likely to occur.

Competition not Efficient

109 AGL argued that the extant competition was not efficient competition because the downstream and upstream markets were not fully competitive, and there was no evidence presented that the prices being charged by EGP were prices that would result from the operation of efficient competition. With respect to the first point, criterion (a) requires a consideration of whether competition would be promoted - not whether it is efficient. With respect to the second point, the AGL argument was that a tariff set under the Code represents the price which would be produced by efficient competition because that is what the Code requires in s 8.1; it then follows that a difference between the Duke tariff and one determined under the Code is evidence that there is not efficient competition even when there is competition in the marketplace.

110 This argument does not take sufficient account of the fact that regulation is a second best option to competition. The complex nature of the tariff-setting process, the number of assumptions it relies on, and the fact that the reference tariff is a publicly available price which may be varied by negotiation between the pipeline owner and user depending on the user's requirements and conditions in the marketplace, all point to the fact that the reference price is not necessarily the price which would result from competition. Indeed, ACCC in its Draft Decision on MSP tariffs pointed out that if the EGP did not exist the reference tariff for the MSP would be lower as it would be transporting more gas. This is not what one would expect in a competitive market (Draft Decision at 97).

Market Behaviour

111 Dr Makholm's statement contained several examples of the effects which could be expected with and without coverage by reference to experience with the regulation of gas pipelines in other places, notably the USA. Without coverage he anticipated that EGP would practice price discrimination to maximise its margins, to raise the cost of entry to potential competitors and to protect the margins of its associated gas marketer (statement of Dr Makholm at par 47). He quoted examples of such behaviour in the USA where pipelines are regulated and three examples in Australia which involve the MSP and AGLGN which are both subject to some form of regulation (at pars 49-53). The argument is that if these practices occur in a regulated market then they will be more evident in one where the EGP is not covered because the Code pays particular attention to preventing these types of abuses (at par 54).

112 As matters currently stand, the Tribunal accepts that Duke sees its commercial interests as being served by maximising throughput through the EGP, rather than in restricting it. It is always possible that circumstances could exist such that it might be in Duke's overall commercial interests to practice discrimination in favour of its associated, or some other, marketer. However, it is unlikely that Duke would be able to practice discrimination on any sustained basis, because of the Duke published prices, the competition between pipelines and high cross price elasticities between pipelines. Whilst recognising the possibility that such discrimination could occur, the Tribunal is not affirmatively satisfied that if it did, it would have a material impact on competition in the market.

113 We have already referred to evidence presented by AGL that preferential treatment was extended to DEATM in relation to overrun charges, whereas Duke contends that the improved terms would be generally available. The Tribunal does not regard the evidence on this point (which, in any event, is equivocal) or the evidence as to the enquiry conducted in relation to AGL, as detracting from the conclusion reached in the previous paragraph.

Information Disclosure

114 Conflicting evidence was presented on whether the information disclosure requirements of the Code would be an incentive to parallel pricing or collusion by EGP and MSP. Dr Makholm said that the Code provisions provide a vehicle for users to protect their rights to non-discriminatory access terms and conditions (statement of Dr Makholm at par 54), while Mr Ergas said that they enable pipeline operators to know the intentions of competitors with respect to future capital expenditure and volumes (market share) and therefore provide the ability to set prices in concert (statement of Mr Ergas at 54-55). NCC acknowledged both these potential consequences but concluded that on balance the information disclosure benefits, in the form of a better-informed market, were likely to outweigh any costs associated with the increased potential for parallel pricing behaviour (Final Recommendation at 74).

115 Dr Makholm's view that the information disclosure associated with coverage was beneficial was based on his view that EGP would engage in discrimination in favour of its associated marketer. As we have concluded that EGP is unlikely to be able to engage in such behaviour to the extent that it would interfere with the operation of a competitive market, it follows that any benefits from information disclosure would be small. This means that we come to the opposite conclusion to NCC: on balance, we prefer Mr Ergas' view.

Market Power

116 Whether competition will be promoted by coverage is critically dependent on whether EGP has power in the market for gas transmission which could be used to adversely affect competition in the upstream or downstream markets. There is no simple formula or mechanism for determining whether a market participant will have sufficient power to hinder competition. What is required is consideration of industry and market structure followed by a judgment on their effects on the promotion of competition.

117 There are strong commercial incentives for Duke to increase the throughput of the EGP, given its high capital cost, low operating costs and spare capacity. There are three pipelines which can supply gas to the market in Sydney, although lesser numbers to the ACT and other places in NSW. The three pipeline operators all stated that it was in their own financial interests to increase market share, and that this may involve undercutting the prices of other pipelines where that was financially justified. Gas producers have significant power in dealing with pipeline operators, as does AGL as the major gas purchaser in the Sydney and Canberra markets. There are alternatives to the use of the EGP for producers and for purchasers of gas which provide a countervailing influence on any attempted exertion of market power by EGP in the transport market. For example, in the case of the Gippsland Basin, gas can be transported to Sydney via the Interconnect or sold into the Victorian market, and in the case of purchasers of gas in Sydney, the Interconnect or the Cooper Basin/MSP can be used as alternatives to the EGP.

118 The existence of spare pipeline capacity over the next 10 to 15 years is a further factor which militates against EGP being able to exert market power to the detriment of competition in the upstream or downstream markets. If transmission prices were increased above competitive levels by EGP, the spare capacity could be used to defeat a price rise, particularly in the first half of the decade when the MSP and the Interconnect could supply all of the forecast increase in NSW/ACT demand with increases in pipeline capacity at relatively low cost. If there were constraints on gas supplies from Moomba, then the spare pipeline capacity may be ineffective in restraining EGP from increasing prices, but we have already concluded that this is not likely over the next 10 to 15 years.

119 AGL submitted that the declining reserves in the Cooper/Eromanga Basin would mean that some gas would have to be purchased from the Gippsland Basin producers, giving market power to EGP (at par 34 of its Final Submission). This submission did not take account of the development of basins to the north of Australia and the effect of the EGP in promoting upstream competition. The NCC argued that there was little likelihood of pipelines serving the basins north of Australia being developed in the short to medium term because of the slow growth in NSW/ACT demand and the low costs of capacity expansion for the MSP and the EGP. This is not borne out by the assumptions underlying the demand forecasts (see par 98 above) and is somewhat in conflict with the NCC method of estimating spare pipeline capacity, which was based on existing installed capacity only.

120 Despite the evidence of competition between pipelines referred to above, it is possible that the competition provided by the Interconnect and the MSP will be insufficient to prevent EGP from increasing the prices of its services and thus restricting output. We do not believe that this will prove to be so. Mr Ergas' SSNIP analysis suggested that relatively small price rises by EGP could be defeated by the Interconnect because it could increase capacity at a cost below the current EGP tariff. He also argued that the MSP could achieve a similar outcome because of the existence of uncommitted capacity (which is expected to increase as the quantities in the AGL contracts with the Cooper Basin producers run down to 2006) and the increased availability of gas due to the EGP foundation contracts (statement of Mr Ergas at 27-34).

121 The statement of Ms O'Reilly of GPU GasNet also supports the likelihood of price competition by the Interconnect. The statement includes estimates of augmentation costs, and tariffs to cover those costs, up to a capacity of 85 PJ/year. Ms O'Reilly's evidence shows that the capacity of the Interconnect could be profitably increased at tariffs which are competitive with the published prices of the EGP. Although it was acknowledged by Ms O'Reilly that capacity would only be increased if underpinned by a long term contract for the transport of gas, the potentially lower tariffs of the Interconnect act as a constraint, or potential constraint, on the pricing behaviour of EGP. Ms O'Reilly's evidence shows that, subject to the matter which she acknowledged, it would be economic in a private cost sense to develop the Interconnect for much of the foreseeable demand for Gippsland gas.

122 The Interconnect has an important characteristic in that there is a very large sunk investment which has increased the southbound capacity to about 34 PJ/year. This means there is significant scope for enhancement of the effective northbound capacity of the Interconnect in the medium term if matching backhaul into Victoria can be developed. The current northbound physical capacity of the Interconnect is about 6.4 PJ/year. There is currently a 5 PJ/year southbound contract, and the demand forecasts include sales from the Cooper/Eromanga Basin of up to 12 PJ per annum into the Victorian market by 2005. This suggests that there is scope for effective forward haul capacity of about 23-24 PJ/year on the Interconnect. This is confirmed by the inclusion of northbound deliveries through the Interconnect increasing to up to 23 PJ/year by 2014 in the EAPL forecasts. In principle, all of this effective forward haul capacity could be developed without any investment on the Interconnect, provided that matching backhaul arrangements can be put in place along the lines projected by EAPL. Development of the corresponding uncontracted capacity by EGP would require an investment in excess of $10 million according to the evidence of Mr McCaul of Duke Australia Operations Pty Ltd. This provides a significant argument against EGP being able to exert market power.

123 The NCC Draft Recommendation did not conclude that EGP had market power and the Final Recommendation did not explicitly state the reasons for the change between the two reports. In submissions, counsel for NCC accepted that there was no explicit statement of the reasons for the change and the only material the Tribunal had to assess the reasons were the (second round) public submissions received by NCC on the Draft Recommendation. The Tribunal reviewed these submissions which contained the opinions and views of various parties but very little evidence one way or the other. Submissions from two potential users of the EGP on NCC's Draft Recommendation argued for coverage because it would provide greater price certainty. Duke submitted that this says nothing about whether coverage would promote competition and the Tribunal agrees. The Final Recommendation gives some weight to the submission from Woodside, as the developer of the Kipper gas field in Bass Strait, which argued for coverage to enable use of the EGP through a connection at Orbost rather than Longford. The transport of gas from that field is still some years away and access or connection to the EGP has not been sought by Woodside; neither of these factors weigh in favour of immediate coverage of the EGP.

124 The Tribunal concludes that EGP will not have sufficient market power to hinder competition based on the commercial imperatives it faces, the countervailing power of other market participants, the existence of spare pipeline capacity and the competition it faces from the MSP and the Interconnect. As EGP does not have market power, the Tribunal cannot be satisfied that coverage would promote competition in either the upstream or downstream markets.

Regional Markets

125 There are several places south of Canberra on the EGP for which the EGP will be the only source of gas. Prior

to the construction of the EGP these places had to rely on electricity or other forms of energy but now have the opportunity to use natural gas. There are currently off-takes from the EGP at Cooma and Bombala in NSW and at Bairnsdale in Victoria, and if the development of the Kipper gas field proceeds it is likely that a connection will be constructed to join the EGP at Orbost in Victoria.

126 The EGP has created a gas sales market, and increased competition in the energy market, in places which were not previously served by a pipeline. The EGP has the potential to increase competition in the gas production market if the Kipper field proceeds. The question which the Tribunal has to address in assessing criterion (a) is whether coverage of the pipeline would promote competition to a greater extent than has already occurred with the access conditions current and proposed on the EGP.

127 NCC's Final Recommendation was that coverage of the pipeline south of Canberra would remove a barrier to entry because EGP, as the sole supplier, would not be able to act as a monopolist. The conclusion was the same in NCC's Draft Recommendation, although its discussion of the issues was more extensive.

128 The evidence and submissions during the hearings did not address regional markets to any great extent, except for the evidence from Mr Ergas. He addressed only the gas sales market and argued that monopoly behaviour was unlikely for three main reasons (statement of Mr Ergas at 35, 46-47). Firstly, the amounts of gas involved are too small to provide an incentive for such behaviour. For example, he estimated that the maximum potential gas use in Cooma and Bombala would be 0.175 PJ/year or 0.3 per cent of the capacity of the pipeline (55 PJ/year). In its Draft Recommendation NCC did not find this reason compelling because the regions served were not small compared to other regional areas with gas supply (at 57).

129 Secondly, as gas has not previously been available, the ability to monopoly price would be restricted because potential users have bargaining power, the costs of conversion to enable the use of gas are significant, and EGP has committed assets which it has incentives to use. In other words, the prices of existing forms of energy will be a countervailing force on the price of gas and pipeline services. The market definition adopted by the Tribunal does not include other forms of energy at the current time where gas is well entrenched, but could include it in the long term when gas is used to generate electricity. In the regional markets, other forms of energy warrant consideration because gas is being offered as an alternative to existing forms of energy. NCC gave some support to this notion in its Draft Recommendation where it said that in deciding whether access to rail tracks will promote competition in the freight market it takes account of road transport (at 56). It argued that the notion is not relevant where there are not competing pipelines, but the freight comparison requires that there be competition between energy sources not pipelines.

130 Thirdly, there is a threat of regulation as an application for coverage can be made at any time. The threat of regulation appears to have been effectively used as a means of moderating the behaviour of pipeline owners in New Zealand according to one of the first round public submissions to the NCC.

131 What coverage may do relative to the existing situation is deter monopoly pricing of pipeline services. Whether this is likely to occur requires some judgment as there is no direct evidence on which to draw.

132 Duke has advertised prices in three zones for the use of the EGP, and has advertised the intention to escalate prices at 75 per cent of the CPI. Bairnsdale is in Zone 1 with a charge of 30 c/CJ ((2000) prices) while Cooma and Bombala are in Zone 2 with a charge of 65 c/CJ. Canberra is also in Zone 2 while Sydney is in Zone 3 (86 c/CJ). With respect to the future, there are two aspects of the Duke standard terms and conditions for access which make monopoly pricing unlikely. Firstly, the advertised intention to increase prices by 75 per cent of the CPI, and secondly, the non-discrimination clause which has the potential to ensure that any benefits due to competition between pipelines (eg in Sydney and Canberra) flow through to all customers including those in the regional markets. In addition, there is the fact that these are new markets for gas which EGP is attempting to develop, in competition with the currently available forms of energy. In these circumstances the prices that EGP can charge for transport will be constrained if market development is to be successful. And there is the threat of regulation, with its associated costs, if prices are increased.

133 Given these factors, the Tribunal is not satisfied that coverage would promote competition in the regional

markets over the existing access terms and conditions.

Conclusion on criterion (a)

134 For the reasons given in earlier paragraphs, the Tribunal concludes that coverage of the EGP will not promote competition in either upstream or downstream markets over the existing voluntary access offered by Duke. The most important factor which underlies that conclusion is our view that EGP does not have, and will not have market power. The arguments advanced by NCC and AGL were largely based upon a contrary assumption as to the existence of market power. The Tribunal is not satisfied that criterion (a) is met either in relation to the pipeline, or in relation to that part of the Pipeline which is south of Canberra.

Criterion (b): "That it would be uneconomic for anyone to develop another Pipeline to provide the Services provided by means of the Pipeline"

135 We have already discussed the meaning of the expression "services provided by means of the pipeline" in pars 65-70 above. It follows from our adoption of a "point to point" characterisation of the haulage services provided by means of the EGP that the MSP is not capable of being developed to provide the relevant services, because the MSP does not accommodate the physical transport of gas between Longford and Sydney.

136 The terms "uneconomic" and "develop" have been discussed in pars 58-64 above. It follows from the discussion of "develop" that it is material to enquire, for the purposes of criterion (b), whether the Interconnect can be developed to provide the services provided by means of the EGP. NCC accepted that the Interconnect could be a potential substitute for the EGP. It concluded that it was not, because its capacity was tightly constrained and it had entrenched cost disadvantages. We review this conclusion below.

137 We agree with the submissions of NCC that the "test is whether for a likely range of reasonably foreseeable demand for the services provided by means of the pipeline, it would be more efficient, in terms of costs and benefits to the community as a whole, for one pipeline to provide those services rather than more than one".

Foreseeable demand

138 The forecasts described earlier (par 93) have a NSW/ACT gas demand of 211 PJ in 2014. The share of that figure which will be sourced from the Gippsland Basin, and therefore require the services of the EGP, or a substitute pipeline, will be affected by a number of factors including the actions of gas producers, wholesalers and retailers, and pipeline operators. At this stage, the foreseeable demand for Gippsland Basin gas over the period under consideration is necessarily speculative. The ultimate capacity of the EGP is 110 PJ/per annum. It seems reasonable to adopt a range of 80-100 PJ/per annum as being the foreseeable NSW/ACT demand for Gippsland gas based on the demand forecasts which assumed that the EGP would be transporting 60 PJ/per annum "within several years" and the demand forecasts that had the Interconnect transporting 23 PJ/per annum in 2014.

Pipeline costs

139 Ms O'Reilly, Mr McCaul and Mr Rochford presented evidence on incremental costs to develop the Interconnect and the EGP. The costs involved are related to the level of the capacity increase which is under consideration. These cost figures can be used to evaluate whether it would be uneconomic to develop the services provided by means of the EGP.

140 Ms O'Reilly of GPU GasNet presented estimates of augmentation costs and incremental tariffs for the Interconnect over a capacity range to 85 PJ/year. Mr McCaul of Duke presented evidence on incremental capacity expansions and capital expenditure for the EGP. These estimates ranged from an initial augmentation to the free flow capacity (64 PJ/year), through further increments of augmentation, and ultimately to the "theoretical fully compressed or maximum capacity" of the EGP of about 110 PJ/year.

141 A detailed report by Mr Rochford, based on his EAPL background, was submitted on incremental options for augmentation of the Interconnect up to a level of about 56 PJ/year. Mr Rochford's costs estimates were less than

those of Ms O'Reilly and Mr McCaul, both of whom represented the pipeline operators. We have therefore relied on their costs.

142 Consideration of those incremental costs indicates that:

- it would be economic to develop the Interconnect to around 10 PJ/year capacity;

- it would be uneconomic to develop the Interconnect beyond 10 PJ/year, and certainly to provide the services provided by means of the EGP for foreseeable demands or to its ultimate capacity.

143 There are two assumptions implicit in these conclusions. First, that the allocative and dynamic efficiency benefits of competition between two pipelines would not be outweighed by the productive efficiency benefits. We note the advice of Mr Ergas that "before you could come to any judgment as to whether in this specific case marginal investment was inefficient from a societal point of view you would need to weigh up these (dimensions of economic efficiency)... and not concentrate... solely on the differential in marginal costs between the EGP and the Interconnect". Mr Ergas said that in applying a social test the gains of allocative efficiency and dynamic efficiency cannot be ignored. However, we do not have any information on the magnitude of allocative and dynamic efficiency benefits and the extent to which these might offset the productive efficiency aspect of this case. Thus, these factors cannot be taken into account. The second assumption is that pipeline capacity means the physical capacity of a pipeline. As noted earlier, there is a potential for backhaul transactions on the Interconnect, which are likely to be a factor in the competitive response to the EGP. If backhaul were included in determining pipeline capacity for the purposes of criterion (b), then it would be economic to develop the Interconnect to a figure greater than 10 PJ/year, but still below the foreseeable demand.

Conclusion on criterion (b)

144 For the reasons given above, criterion (b) is met because it would be uneconomic in a social costs sense to develop the Interconnect to provide the services provided by means of the EGP.

Criterion (d): "That access (or increased access) to the Services provided by means of the pipeline would not be contrary to the public interest

145 NCC submitted, and we agree, that criterion (d) does not constitute an additional positive requirement which can be used to call into question the result obtained by the application of pars (a), (b) and (c) of the criteria. Criterion (d) accepts the results derived from the application of pars (a), (b) and (c), but enquires whether there are any other matters which lead to the conclusion that coverage would be contrary to the public interest.

146 As the Tribunal is not satisfied that criterion (a) has been met, it is not necessary for us to give independent consideration to criterion (d).

147 Conclusion

1. The Tribunal orders that the decision of the Minister made on 16 October 2000 that the Eastern Gas Pipeline should be a Covered Pipeline be set aside.

2. In lieu of that decision, the Tribunal decides that the Pipeline is not covered.

3. No submissions were put on the issue of costs except by AGL who contended that no order should be made as to costs. The Tribunal is tentatively of the view that there should be no order as to the costs of the proceedings. It will, however, reserve to any party liberty to apply by motion filed prior to 10am on Tuesday 8 May for an order as to costs in case the failure to put any submission on the question of costs was due to inadvertence.

I certify that the preceding one hundred and forty-seven (147) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justice Hely, Dr M J Messenger and Miss M M Starrs.

Associate:

Dated: 4 May 2001

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Dates of Hearing:	29 January-8 February 2001
Date of Judgment:	4 May 2001