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LAWYERS

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Dear Mr Willett

AGL Application for Coverage of the Eastern Gas Pipeline ('EGP')

I refer to our recent meetings and discussions consequent upon the lodging of a further submission by *Duke Energy International* ('DEI') supported by an extensive submission prepared by the *Law and Economics Consulting Group* ('LECG') in conjunction with DEI, with the *National Competition Council* ('NCC').

As you know, those meetings were quite extensive and dealt with a range of issues. DEI, LECG and ourselves have indicated that should the NCC have any issue it might wish to discuss further before making a 'recommendation', to the Minister, each of these parties are available for further consultation. As you know, DEI has expressed some views recently on the issues raised by the submission of 9 June 2000 lodged by Woodside Energy Limited.

Against the background of the recent meetings, there are 2 specific matters that require additional comment.

The first deals with the question Mr Willett raised in our meetings concerning the extent to which the NCC must be 'satisfied' of the relevant matters properly brought to consideration by the criteria set out in clause 1.9 of the Code. The issue here is the *degree* of satisfaction which must be reached by the NCC before it can recommend coverage of the asset. The second matter involves the extent to which it is appropriate for the NCC to rely upon a *suspicion* or *apprehension* that a party might engage in some aspect of anti-competitive conduct as a significant element of the NCC's 'satisfaction' that competition in an upstream or downstream market will be made 'better' (that is, promoted) by the intervention of coverage.

The argument articulated by the NCC and reflected in the draft recommendation is that the 2 significant parties delivering natural gas into the Sydney market, in competition with each other, will be disposed to collude on market sharing arrangements or prices and such collusion (however it manifests itself) is a barrier to entry which would be eliminated by regulation of the EGP.

Apart from the argument that there is no evidence at all of actual or threatened collusion or, in the circumstances of these markets, that the NCC could not *reasonably* hold a well founded apprehension that such conduct might occur, DEI has strongly argued that the NCC should allow competition to play itself out in a rivalrous way to determine, measure and identify, over the short and medium term, actual conduct and experience the character of competitive behaviour. This is the 'wait and see' notion DEI has argued for as a compelling answer to recommendations about coverage based on apprehensions about possible collusive conduct. No doubt, parties concerned about anti-competitive behaviour, should that emerge, will make a further application to the NCC for coverage and regulation of the asset. Against the background of actual experience, the NCC may then have a basis for forming clear views about whether coverage of the asset will, in the then prevailing circumstances, have the effect of promoting competition in an upstream or downstream market and making competition in those markets measurably 'better'.

Degree of Satisfaction

As you know, LECG in its submission has argued strongly for the adoption of an approach to the *standard* or *degree* of satisfaction that requires the NCC to be satisfied beyond reasonable doubt that all of the statutory criteria are made out. The notion that the NCC must be satisfied beyond reasonable doubt is a useful analogue for measuring the high threshold of satisfaction that must subsist before the NCC can be satisfied that the asset should be regulated under the terms and conditions of the *National Third Party Access Code* and *Gas Access Law*.

The argument that the NCC must be satisfied beyond reasonable doubt in an analogous way to the standard of proof that applies when courts are considering the burden of satisfaction about the commission of a criminal offence (for example) arises out of two things. Firstly, an assessment of the very significant consequences that arise from regulating or covering the asset when there might be some reasonable doubt that coverage is not appropriate or not made out, in terms of the criteria, and secondly, as a result of a conclusion that seems to inevitably follow from the statutory *direction* to the NCC that regulation of the relevant asset is *prohibited* unless the NCC is satisfied of all 4 of the criteria (any consequence of all of the underlying factual matters that go to making out satisfaction). That gravity of the degree of satisfaction that must subsist by force of the NCC being prohibited from recommending coverage unless all 4 criteria are made out is reenforced by the prohibition upon coverage should the NCC be not satisfied about any one of the criteria.

The statutory prohibitions recited in clause 1.9 of the Code not only deal with the criteria that *must* apply but provide a statutory indication of the way in which the NCC must approach the coverage issue. It is not enough for the NCC to be reasonably satisfied. The NCC must have a *high threshold of certainty* that each of the criteria are made out. The NCC must reach a *considered* judgment. That seems to us to mean, in the context of the Code, that the NCC ought not and cannot recommend coverage if the NCC holds any reasonable doubt about whether all 4 of the criteria are made out.

In the LECG submission, the economic authors of the document talk about an 84% degree of satisfaction. What that statistical notion conveys is that should the NCC have a degree of reasonable doubt (say of the order of 16%), that would be a sufficient degree of reasonable doubt that would cause the NCC to question whether it can be satisfied, in the statutory sense applying here, for the regulation of major investments in the Australian market relating to gas transmission assets. The statistical figure of 16% is simply an analogue for expressing the notion that where there is a reasonable doubt about relevant matters, the NCC cannot be satisfied

for the purposes of the Code or the Gas Access Law on the questions it must consider in this application.

Cases where a decision maker or a tribunal is charged with a responsibility to consider a matter are not very helpful when the question to be decided is the degree or gravatus of satisfaction that must subsist when 4 matters must all be met and where a failure to meet any one of them must necessarily result in non-intervention. To the extent that discussions about the distinctions between the standard of proof, in the technical sense, that prevails in relation to a criminal enquiry as opposed to a civil issue are relevant in the general sense, the most recent expression of this dichotomy is seen in the following passage[1]:

> '*..there is not some standard of persuasion which is fixed, intermediate between the satisfaction beyond reasonable doubt required upon a criminal inquest and the reasonable satisfaction which in a civil issue, may (not must) be based upon a preponderance of probability.*'

In this decision, the majority of the High Court relied upon the 1938 decision of *Briginshaw v Briginshaw*[2]. In that decision, Chief Justice Latham acknowledged that for civil issues the degree of satisfaction demanded may depend rather on the *nature* of the issue. The Chief Justice went on to say that 'no court [and in the circumstances of this application, the NCC] should act upon mere suspicion, surmise or guesswork. In a civil case, fair inference *may* justify a finding upon the basis of preponderance of probability. The standard of proof required by a cautious and responsible tribunal would naturally vary according to the *seriousness* or *importance* of the issue.'[3]

Apart from recognising that the degree of proof or satisfaction that should subsist will vary according to the seriousness of the consequences, we observe that the degree of satisfaction will vary according to the *statutory framework* within which the decision is made and this is particularly so where the instrument [in this case the Code] directs all 4 matters to be met reinforced by a prohibition upon intervention [regulation/coverage] where any one matter is not met.

In our view, in applying clause 1.9 of the Code, the NCC needs to consider:

- That the *degree* of probability depends on the subject matter.[4]
- The *gravity* of the subject matter before the NCC and the *consequences* that may follow.[5]

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1 Cassell v The Queen [2000] HCA 8

2 60 CLR 336

3 ibid, at page 343

4 Blyth v Blyth [1966] 1 All ER 524

5 Robinson v Cox 21 SASR 536

- That where an issue such as the *promotion* of competition in another market cannot be assessed or measured, the NCC cannot be *satisfied* on that question.[6]

  This further supports the argument that the NCC should 'wait and see' how competition develops in the market.

- That the NCC is not bound by any rigid rules but should apply its mind to the particular facts of the individual case and form a considered judgment upon them in the light of its knowledge of the conditions surrounding the situation including the circumstances affecting the likelihood of error.[7]

- That the nature and gravity of the issues necessarily determines the manner of reaching satisfaction of the truth of the issue and that the presumption of innocence [for example in relation to notions of apprehended anti-competitive conduct] is to be taken into account.[8]

It seems to us that the result of these factors and the statutory framework of the Code requires the NCC to reach a high threshold of satisfaction and that should it hold a reasonable doubt about whether any one of the criteria are made out, no recommendation for coverage should be made. In a sense, being 'satisfied' is an absolute test. The NCC cannot be *half satisfied* or *arguable satisfied* or *merely reasonably satisfied*. The direction that all 4 matters must be made out requires the NCC to be confident that it is *affirmatively* satisfied. If, for example, the NCC cannot, on all of the evidence, conclude affirmatively that competition in upstream or downstream markets will be better off by intervention, in conjunction with the other factors in clause 1.9, it could not say that it was statutorily satisfied and must recommend against coverage.

In addition, the NCC needs to form a view about the inter-relationship between each of the criteria and their interdependence. In our view, criterion (a), (b) and (d) are particularly important subject matters.

Under criterion (a), it is necessary for the NCC to find that regulated access to the services of the EGP *under the Code* [rather than access otherwise] would promote competition in another market beyond that which would otherwise exist. This task is made extremely difficult for the NCC in circumstances where the development of the market is at such a premature stage. It would be wrong for the NCC to engage in any degree of '*guesswork*' in assessing this criterion.

In order to obtain the benefits of regulated access to the services of the EGP, the NCC would need to be satisfied to a high level of probability that this condition holds before it can say that the criterion is *satisfied*. This is because the promotion of competition is a central issue to the third party access regime.

Likewise, for the NCC to find that criterion (b) holds, it must carefully consider and assess the issues surrounding the development of a national gas market. While point to point duplication of

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6 Fryar v Systems Services 125 ALR 592

7 The Collector of Customs in the State of Victoria & Anor v Wilhelmsen Agency Pty Ltd (1945) 102 CLR 147

8 Wright v Wright (1948) 77 CLR 191

pipelines is unlikely, competition between pipelines from alternative gas sources could only be expected (particularly in relation to the delivery of gas into the Sydney market). To ignore the development of a system of interconnected pipelines would be to underestimate the importance this criterion has to a coverage decision. Again, the NCC would need to be *satisfied* to a high level of probability that this criterion holds.

In terms of a coverage decision, criterion (c) is of lesser importance. It simply holds or does not hold. Finally, whether criterion (d) is *satisfied* depends on the weight to be given to those arguments which suggest that regulated access to the services of the EGP would be contrary to the public interest.

On the whole, a decision to recommend coverage of the EGP is a very important issue. Not only from an investment and incentives perspective concerning private assets but also from the public's perspective. A decision to regulate the services of the EGP, according to the provisions of the Code, will not only affect the development of competition between DEI and EAPL, but will also have immediate signalling effects to the wider investment community.

Anti-competitive behaviour

In its Draft Recommendation the NCC said that 'there is scope for some form of *explicit* or *tacit collusion* between the two pipeline owners which is *beyond the reach of Part IV of the TPA*'. The NCC also asserted that an 'important question is whether **access regulation** is an effective way of dealing with the **risk of collusion**'.[9]

These observations have no real role to play in applying the criteria. Access regulation is not a mechanism for risk managing apprehensions about possible tacit collusion whether that collusion might be beyond the reach of Part IV or not.

Our view in this regard is supported by the NCC's own observations in dealing with applications under Part IIIA of the *Trade Practices Act 1974*.

For example, during the course of delivering its recommendation on the *Carpentaria Transport Pty Ltd* application for declaration of services under Part IIIA of the *Trade Practices Act*, the NCC considered 'that it would be **inappropriate** to use Part IIIA to address issues of **market conduct**. Similarly, an applicant's potential or otherwise to be involved in anti-competitive behaviour is an issue which should be addressed under Part IV, **not** under Part IIIA.'[10]

Further, the NCC commented in the *Specialised Container Transport* reasons for the recommendation in that case that 'any concerns about market conduct of either party falls within Part IV of the TPA, for which the ACCC is responsible, not the NCC.'[11]

In summary, the NCC should not regard the Code as a means of addressing apprehended market conduct. Access regulation should not be used as a device to deal with the risk of collusion. To do so, would suggest that the NCC is reaching beyond the purpose and intent of the Code. This

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9 pages 59 - 60 of the Council's Draft Recommendation

10 at page 70,292

11 at page 70,425

is a different consideration from the way in which the NCC might examine actual conduct in a dependent market over time where there is clear evidence of unconstrained collusive behaviour regardless of whether the ACCC has acted to prevent the conduct. The intervention or exercise of regulatory oversight by the ACCC would be a material matter but the NCC could legitimately examine the actual market experience in dependent markets or in the market of a service provider when a coverage application came before it. That experience would be a relevant matter in determining whether coverage, in all the circumstances then known, would promote competition in the dependent market by bringing into play terms and conditions of access under the Code which would constrain behaviour operating as a barrier to entry.

However, using the criteria under the Code as a mechanism for risk managing suspicions about potential anti-competitive conduct or the risk of collusion seriously misapplies the access criteria. That approach forms no part of access regulation for the purposes of this application.

Instead, the NCC's role is to assess the criteria on a transactional basis in the circumstances of the particular markets which are affected by the introduction of the transmission service and in which competition will occur.

We hope these additional comments go some way in assisting the NCC in its deliberations.

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