



Tel: 02 9921 2585
Fax: 02 9921 2772

The Australian Gas Light Company
ABN 95 052 167 405

St Leonards
72 Christie Street
St Leonards NSW 2065

Locked Bag 1837
ST LEONARDS NSW 2065
www.agl.com.au

Manager -MCE Secretariat
Department of Industry, Tourism and Resources
GPO Box 9839
CANBERRA ACT 2601

30 November 2005

By email: MCEMarketReform@industry.gov.au

Public Consultation on Response to Productivity Commission Review of the Gas Access Regime

AGL is pleased, in addition to its presentation to the SCO on 23 November, to comment on the SCO's 9 November Consultation Paper.

The Consultation Paper addresses four major policy matters (Objects Clause, Coverage Test and Administration, the Monitoring Option and Greenfields investment measures) and proposes that a range of matters associated with the process and principles for regulation of prices, terms and conditions of access should be referred to an Expert Panel. A key task of the Expert Panel is to consider how to achieve appropriate consistency across energy infrastructure types (gas and electricity transmission and distribution).

Major Policy Matters

AGL believes the Consultation Paper's responses to the Productivity Commission's (PC) report are positive. However, AGL submits that some modifications are needed to ensure that the division of responsibilities between the MCE, the AEMC and the AER is consistent with their agreed roles.

Objects Clause

AGL supports the introduction of an overarching objects clause in place of the range of objectives and factors in the current regime. It is our view that wording in the amended Part IIIA of the Trade Practices Act is preferable to the objective proposed in the consultation paper, as it offers greater certainty for investors, while at the same time serving the long term interests of consumers.

Coverage

AGL supports the Consultation Paper's proposal to adopt the PC's recommendation on revision of the coverage test to require that a "material" increase in competition be necessary before coverage can be mandated. This is consistent with the amendments to the National Access Regime test for declaration which is the general regime equivalent to coverage under the Gas Access Regime. AGL believes that the proper body to make recommendations in relation to coverage is the National Competition Council (NCC) as it is the national body responsible for recommendations for declaration decisions. This will ensure recommendations of this type rest with a single instrumentality which has built up a complete and wide-ranging body of knowledge, rather having two separate instrumentalities dealing with declaration/coverage. Additionally AGL's understanding is that the AEMC's role is properly concerned with rule-making for access and market development. Consequently extending coverage/declaration type decisions to the AEMC is clearly less compatible with its role than with the NCC's.

Monitoring Option

AGL supports the proposal in the SCO paper to include a monitoring option which includes major elements of the PC's recommendations. The inclusion of this option will reduce unnecessary regulation of energy infrastructure which has minimal market power. AGL is of the view that, since the choice of criteria for determining the appropriate form of regulation is a significant policy matter, these criteria should be determined by the MCE, and included in the National Gas Law consistent with the SCO's proposed approach to the Gas Legislative Package. AGL submits that there should be a separation between decisions about economic regulation of access and which form of regulation should be applied. AGL also considers that if coverage is recommended, the NCC is the proper body to determine which form of regulation should apply.

Greenfields

AGL endorses the Consultation Paper's proposals to enhance regulatory certainty for greenfields investments. Both the 15 year binding non-coverage ruling and the 15 year price regulation free period will provide an improved environment of regulatory certainty for pipeline projects. The inclusion of both measures is important to ensure that unnecessary regulation can be avoided where time and circumstances permit a non-coverage decision to be made; alternatively, the requirement to comply with non-price regulatory arrangements will substantially constrain any market power, should it exist.

AGL submits that the criteria for the 15 year price regulation free period would benefit from refinement as follows:

- Transmission criteria: criterion (c) be amended to clarify the meaning of "market", and to remove or simplify the requirement for greenfields status to apply only pipelines to which are "independent", as this may unnecessarily impede greenfields investment;
- Distribution criteria: criterion (e) be removed as it appears to be unnecessary. This is because it would be inappropriate for a relevant energy Minister to designate only certain areas of a State or Territory as being open for Greenfields distribution developments. The result would be a restriction on economic growth in undesignated areas simply by a decision not to facilitate natural gas supply.

Expert Panel

Consistent with views put to the SCO in previous consultations, AGL supports the pursuit of a national approach to energy access, with alignment of the electricity and gas regimes where appropriate. In this regard AGL endorses the MCE's decision to proceed with a 'certification' model under part IIIA of the Trade Practices Act.

In considering the development of the national approach AGL agrees with the direction of the Productivity Commission's report on the Gas Access Regime, namely that the Regime needs changes, but that overall the scheme is sound. AGL accepts that the PC's recommendations should be reviewed in the light of recent MCE policy decisions to consider how alignment can be achieved, where it delivers real benefits to the frameworks.

AGL is of the view that the draft Terms of Reference for the Expert Panel as set out in the Consultation Paper are broad and uncertain, and that they should be clear and focused in order to match the time available.

In this regard AGL submits that the starting point for the Expert Panel must be clear, including the following key elements:

- *MCE Policy direction in relation to a national approach to energy access*, namely that consistent approaches to determining prices, terms and conditions for access should be consistent where it is efficient to do so, and differences should apply where this is the better approach;
- *The new energy market governance structure* consisting of the MCE, AEMC and the AER;
- *Consistency with the National Access Regime* as updated as part of the Government's response to the PC's review;
- *Adoption of the 'certification' model for energy access*;

- *The existing Gas Access Regime* in conjunction with the PC's recommendations for improvement; and
- *The existing Electricity Regime* embodied in the National Electricity Law and the National Electricity Rules.

It is also important that the Expert Panel has clearly defined tasks, as its timeframe and resources are limited. In this regard an open-ended review to develop model legislative provisions' and 'model contents' is a big challenge and may be seen as contemplating wholesale changes away from current gas and electricity regimes which would be unsettling for participants.

Another item which requires clarification is the status of PC recommendations nominated for the Panel's consideration. AGL submits that there are a number of PC recommendations which are either consistent with the National Access Regime or represent minor changes with respect to the existing gas regime, and therefore do not need to be reviewed.

A simpler approach to the proposed Terms of Reference would be to specify that the existing regimes, including the PC's recommendations, be the starting point for the review and only seek changes where these are needed for consistency. As part of this approach, the Expert Panel should be directed to focus on high-level matters. Matters such as detailed consideration of alternative pricing methodologies, such as TFP, are beyond the reasonable scope of the Expert Panel with the time and resources available. It would, however, seem appropriate for the Expert Panel to consider whether the PC's recommendation to allow for methodologies other than "building blocks" - such TFP - remains appropriate.

A set of modified Terms of Reference reflecting the comments above is attached for the SCO's consideration.

Regulatory discretion – "Reasonable Ranges"

Concern has been raised by some members of the SCO that a requirement for the regulator to accept costs (particularly the cost of capital) proposed by a Service Provider if they lie within a reasonable range, means that Service providers will deliberately "target" the top end of the reasonable range and, as a result, this will enshrine a right to some form of legal bias, allowing Service Providers to abuse market power.

AGL is of the view that this concern is unfounded for two reasons.

First, estimating a Service Provider's efficient costs is not something that can be done with a high degree of precision, particularly in the case of the cost of capital. This means that even the person with the best information can only estimate the costs as being within a reasonable range. In fact all of the points within the range are valid, as this is a probabilistic process rather than a deterministic process. There is no "correct" answer, or even one that is a "stand out" when compared with other estimates within the range. We simply have a high level of confidence that the correct answer is somewhere within the range.

Secondly, under these circumstances it is valid, and even preferable, to target a point at the upper end of the range in order to deliver the widely accepted requirement that there be a low probability that the estimated costs are below the "correct" (but unknowable) value. This approach is essential in order to deliver the economic outcomes which support the long term interests of consumers.

In summary, as the "true" efficient costs can only be estimated within a reasonable range, any answer within that range has the possibility of being correct. However, since the long term interests of consumers are best served by correct economic outcomes, selection of values within the upper end of the range is in fact clearly preferable to their underestimation.

If you have any queries, please contact me on (02) 9921 2585.

Yours faithfully,

Dr Robert Wiles

General Manager Regulation and Policy

Attachment

Expert review of the guidance for a national approach to economic regulation for energy transmission and distribution network access

Terms of reference

Background

One of the key themes of the reforms to the energy markets being pursued by the Council of Australian Governments (COAG) is to improve the governance arrangements for the industry – including the governance of economic regulation – and otherwise to streamline and improve the quality of economic regulation across energy markets.⁷

Pursuant to these objectives, COAG has already agreed to reform the institutions operating across the energy markets in pursuit of this objective, with the new structure to be as follows:

- *The MCE* – the national policy and governance body for the Australian energy market including for electricity and gas, with a power to direct reviews by the Australian Energy Market Commission (AEMC) with respect to rule-making and market development;
- *The Australian Energy Market Commission* – responsible for rule-making and market development functions in respect of electricity and natural gas transmission and distribution networks and retail markets (other than retail pricing); and
- *The Australian Energy Regulator (AER)* – responsible for enforcement of the rules for the National Electricity Market (NEM) and economic regulation of electricity and gas transmission and distribution networks and retail markets.

The legal framework for economic regulation in both the electricity (NEM) and gas is also being modified to consist of:

- the **law** (National Electricity Law (NEL) and National Gas Law (NGL)) – to be modified by Parliaments, consistent with the processes set out in the COAG *Australian Energy Market Agreement*;
- **statutory rules** (National Electricity Rules and National Gas Rules) – which will be under the control of the AEMC, subject to the procedures set out in the NEL and NGL; and
- **statements of policy principle** from the MCE to the AEMC – subject to the procedures set out in the NEL and the Australian Energy Market Agreement.

A further integral component to the achievement of COAG's reform program is the rationalisation of the regulatory regimes applying to electricity and gas transmission and distribution, which is recognised in COAG's in-principle agreement to adopt a national approach to energy access under the *Trade Practices Act 1974*, covering electricity and gas transmission and distribution.⁸ To this end, COAG decided to replace the numerous state, territory and national regulators with a single regulator and the MCE agreed to 'certification' as the national model for energy access. Alone,

these decisions will not create a consistent approach to regulation across the energy sector. Rather, where appropriate, and where effective regulation is not impeded, a consistent set of legal provisions (that is, the law and statutory rules as described above) to guide market participants and regulatory bodies across electricity and gas transmission and distribution across jurisdictions is desirable.

The national framework for access is set out in Part IIIA of the Trade Practices Act. This regime was reconsidered by governments and changes to the TPA have been tabled in Parliament following review by the PC in 2000-01.

The gas access regime is set out in the GPAL and Gas Code. It has operated as a national regime since 1998 subject only to derogations in Queensland that grandfather specific access provisions in place prior to introduction of the Gas Code. The Productivity Commission recently undertook a review of the Gas Access Regime and made a series of recommendations on high level policy matters (such as inclusion of an overarching objects clause, coverage criteria, inclusion of a light handed alternative regime and treatment of greenfields projects), on the procedures required to be followed, and on the detailed guidance that is provided to regulators.

The electricity access regime is set out in the NEL and NERules. It is a national framework that provides high level guidance for market participants and regulatory bodies; specific access regimes are detailed in the ACCC's Statement of Regulatory Principles (for transmission) and in various jurisdictional and regulatory instruments and practices for distribution. Recent changes to the National Electricity Law put in place (amongst other things), a revised legal framework for electricity access regulation, setting out the powers, rights and obligations on the various parties, as well as the high level constraints and criteria for the AER and AEMC. The NEL also requires the AEMC to introduce a new set of rules governing the setting of regulated prices for electricity transmission (covering the detailed criteria for prices as well as the relevant procedural requirements for the AER), and the AEMC has commenced this task. No equivalent process has been developed for electricity distribution.

In addition, the MCE has commenced work on examining the issues associated with creating a national framework for regulation of electricity and gas distribution and retail (other than retail pricing), including the release of an Issues Paper in August 2004. This project is essentially about managing the transfer of regulatory responsibilities from the jurisdictional regulators to the AER.

A key objective for the realisation of COAG's vision for reform is to bring together the current reforms being undertaken to ensure that a national approach to energy access covering electricity and gas transmission and distribution ultimately is achieved.

Tasks for the Expert Panel

The Expert Panel will be required to provide the MCE with a report that recommends a program to deliver the CoAG vision of national approach to access including specific recommendations on where modifications are needed to the existing gas regime and to the existing electricity regime, and where it is appropriate to retain differences.

In undertaking this review, key areas upon which advice is sought include:

- the desirability of the law and statutory rules to be common across all sectors, and in parallel, to identify and clearly articulate those areas where the technology, market circumstances or other factors may necessitate distinctions in the access law and rules between electricity or gas and/or between transmission and distribution sectors;
- the specific recommendations from the PC's report referred to in Appendix 1 of the SCO Consultation Paper; and
- other matters for further consideration (eg approaches to WACC; alternatives to the building block approach, etc.).

The Panel should take into account all of the relevant existing access models, the reform efforts that are being pursued and the recommendations in relevant reports, which will include at least:

- The recommendations and findings of the Productivity Commission's Review of the Gas Access Regime, and the MCE's response to those recommendations;
- The recommendations and findings of the Productivity Commission's Review of the National Access Regime, and the Australian Government's response to that review;
- The pricing principles proposed for the National Access Regime and the certification criteria;
- The Gas Pipelines Access Law and the current Gas Code;
- The National Electricity Law and the current National Electricity Rules;
- The recommendations of Prime Minister's task force on export infrastructure; and
- The electricity access regime recently introduced in Western Australia.

For the purpose of its review, the Panel is not required to review the following matters, which should be taken as given for its exercise:

- the objects clause currently contained in the NEL and the objects clause that the MCE has agreed to for the NGL (except to the extent that a single but equivalent objective could cover the whole energy sector);
- the existence of the current coverage test for gas infrastructure and continued regulation of electricity transmission (although advice on the applicability of a coverage test for electricity distribution is sought); and
- the measures the MCE has agreed to increase regulatory certainty for greenfields projects.

The panel will be required to release an issues paper for consultation with interested parties, provide interim recommendations to the MCE and a final report in time to meet the MCE timetable for the development of the national gas legislation in 2006.

⁷ AEMA, clauses 2.1(b)(i)-(ii).

⁸ AEMA, clause 1.4 and annexure 1.