



**APIA Submission to Ministerial Council for Energy –
Senior Officials**

**Discussion Paper : Application of the Industry Levy to fund
the AER and AEMC**

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INTRODUCTION

The Australian Pipeline Industry Association (APIA), the peak national body representing the interests of a wide range of stakeholders in the natural gas transmission pipeline industry, welcomes the opportunity to comment on the Ministerial Council on Energy (“MCE”) Standing Committee of Officials’ Discussion Paper entitled “*Application of the Industry Levy to fund the AER and AEMC*”, dated March 2004.

APIA is the representative of both the owners of gas transmission pipeline systems in Australia and the variety of service providers that rely upon the continued viability of these pipeline owners for both their own commercial wellbeing and their ability to expand. APIA believes the need for a well planned regulatory framework that promotes investment is critical. This planning extends to the basis on which the costs of implementing and applying that framework are to be applied.

Accordingly, APIA submits that there must be compelling reasons to justify the establishment of an industry levy or one that requires service providers to bear any of the costs associated with regulation. The APIA is yet to see such reasoning.

With that in mind and before commenting upon the particulars of the Discussion Paper, APIA makes some overarching comments concerning the proposal. These are outlined in the next section of the submission.

It is also noted that the discussion paper does not discuss the legal or constitutional issues associated with the implementation of industry levies. APIA considers that this is a fundamental issue, if only to identify which of the proposals should not be considered because of these barriers. It urges the MCE to therefore make available to stakeholders any legal advice it might obtain in connection with this point relating to any potential model being considered by the MCE.

APIA has made numerous submissions in various forums on the issue of industry levies. While this submission attempts to restate all points made in those submissions, to ensure that the MCE has all relevant information before it, APIA will submit under separate cover extracts from those submissions relating to industry levies, in particular:

- Submission to Western Australian Department of Treasury and Finance on the proposed Draft Economic Regulation Authority Bill, dated 15 April 2002;
- Submission to Western Australian Department of Treasury and Finance on Draft 4 of the Economic Regulation Authority Bill, dated 10 October 2002;
- Submission to the Productivity Commission of September 2003
- Other submissions as appropriate

OVERARCHING ISSUES

APIA makes the following overarching comments in relation to the proposal for an industry levy.

1. Incentives to investment a priority for any regulatory reform

In so far as the gas industry is concerned, any reforms that are implemented in this area must not act as a disincentive to private sector investment in infrastructure. This is particularly important in light of the review currently being undertaken by the Productivity Commission of the Gas Access Regime. Obviously it is vital to avoid the extension or creation of any framework that has the potential to reduce the incentives for private investment in publicly essential infrastructure or which is likely to impede improvements to productivity and the efficient provision of public utility services such as gas pipelines.

2. Focus on current areas of reform “misses the mark”

APIA is concerned that a disproportionate priority is being afforded to such areas of reform as the industry levy and the single national multiple industry regulator. Given the reform objectives stated by Ministers in their 11 December 2003 communiqué, it is essential that the MCE reform process not place any disproportionate importance on such matters over the more substantive reforms required to the design of the framework that must be applied and for which costs are to be incurred by Regulators.

This issue is even more important given that the current round of energy related reforms are proceeding at a time where no clear national energy policy has been developed.

3. Costs of regulators should be borne from Consolidated Revenue

APIA has serious doubts as to whether any cost recovery mechanism is appropriate. More importantly however, it submits that there are compelling reasons for why the costs incurred by regulators in carrying out their various functions should be borne from consolidated revenue of state and federal governments. They are:

- In the absence of state and federal government initiatives, the costs of regulation would not be costs incurred by pipeline businesses. Contrary to the assumption made in the MCE discussion paper, pipeline businesses do not give rise to the costs of regulation. In these circumstances, recovery of the costs of regulation via an industry levy would be no more than the imposition, under another name, of a tax on the pipeline industry. Like all specific taxes, an industry levy would be inherently economically inefficient. Its imposition would be in conflict with the concern for efficiency that has significantly motivated energy market reform to date. It would also be in direct conflict with the way in which energy market regulators have interpreted the mandates they

have been given in the reform process. If economic efficiency remains a reform objective, the costs incurred by regulators must be borne by Consolidated Revenue, and funded from broad-based taxation revenues. The imposition of an industry levy or similar mechanism, which recovers the costs of regulation from pipeline businesses, would sacrifice economic efficiency in the interests of political and administrative convenience.

- The issue of industry levies was debated as part of the reforms to the regulation of gas pipelines conducted in the mid to late 1990s. At that point in time, it was concluded that an industry levy was not appropriate. The APIA does not consider that the facts and circumstances have changed to now justify the imposition of industry levies.
- Regulation of essential infrastructure such as electricity and gas pipelines is supposedly for the benefit of the entire community. So too is the regulation of telecommunications infrastructure – another essential infrastructure – yet the costs associated with the regulation of this industry are borne from consolidated revenue. There would seem little reason to treat pipelines differently to other classes of infrastructure.
- It is important to remember that less than seven years ago, CoAG developed a scheme which was aimed at defraying the costs the States were to incur as a result of implementing national competition policy reforms. This scheme covered the costs involved in establishing and operating the very institutions established to apply the regulatory frameworks that were at the heart of the NCP reforms. The MCE has now decided that these institutions are no longer effective. It seems incongruous that less than seven years after their establishment, industry is now being asked to fund their disbandment and the establishment of a new institutional framework.

4. Lack of Justification for an industry levy

APIA is concerned at the lack of justification in the discussion paper and the MCE communiqué for the implementation of an industry levy other than it is important for “economic efficiency” reasons.

Furthermore, there appears to be a presumption that 100% of the costs are to be recovered from industry. However, there is no assumption from the communiqué that this should occur. This will be particularly important if regulators are to be afforded wide ranging powers and functions extending to exercising enquiry functions.

Without proper justification for a course of action, stakeholders are unlikely to have confidence that the arrangements eventually implemented represent the most optimal framework or that it has been efficaciously implemented. This is particularly important given that to date, there has been no quantitative

analysis undertaken to demonstrate the efficiencies likely to be generated by a single, multi industry, national regulator. In fact, evidence in other jurisdictions suggests that there are no cost savings. To the contrary, the only evidence APIA is aware of points to the creation of a single “super regulator” as leading to increased costs. Unless appropriate levels of control and accountability are placed on the proposed regulatory institutions, industry could be faced with an extensive increase in costs. APIA’s September 2003 submission to the Productivity Commission estimated the first round of regulatory reviews (excluding litigation) involved costs in the order of \$14 million for service providers. If the costs associated with litigation are included, this cost increases to approximately \$27 million. This cost is additional to the estimated cost of regulatory bodies in gas transmission regulation in the order of \$4-5 million per annum over recent years. Without any attempt to quantify the benefits of the proposal or the likely costs involved, it will not be possible to:

- benchmark the present costs and accurately estimate the magnitude of the cost and efficiency benefits;
- determine an appropriate budget for the development of any industry levy; and
- subsequently measure the effectiveness of the proposal and monitor ongoing performance in a manner which provides a firm basis upon which the framework, procedures or practises can be improved if necessary.

Finally, the appropriateness of cost recovery by government agencies is the subject of the Productivity Commission’s report into cost recovery by Commonwealth government agencies.¹ The APIA urges the MCE to take notice of relevant recommendations of this report before deciding whether cost recovery is appropriate. Some key pertinent comments from the report are as follows:

- The proper scrutiny of cost recovery requires that better information be available to users and the government on an ongoing basis. The Commission has made various recommendations to address these needs.
- The Commission supports the strengthening of consultative arrangements where necessary and suggests the adoption of the following criteria for consultative committees: stakeholder representation; an independent chairperson; the ability to monitor agency efficiency; access to adequate information and transparent processes.
- Regulatory agencies potentially undertake a variety of activities. The general principles suggest that registration, monitoring compliance and issuing of exclusive rights would be assessed for cost recovery, while other activities usually would be funded from general taxation revenue.

¹ Productivity Commission, Cost Recovery by Government Agencies – Inquiry Report, dated 16 August 2001 but publicly released only on 14 March 2002

5. What if an industry levy proceeds?

While APIA can not impress upon the MCE the importance of the comments made in items 3 and 4 above (ie that the costs of regulation should be borne from consolidated revenue), if an industry levy is to be implemented, the fairest model is one which requires the costs of regulation (which includes not only the costs of the Regulator but also the costs of any body charged with having to act as the collection agency) to be borne by the prime beneficiaries of regulation - ie the users and potential users of regulated assets.

Subject to the above comments, APIA submits that the following features must be present in any framework that is implemented:

- Service Providers should not be burdened with the task of collection agencies. To do so places them in the invidious position of having to participate in regulatory approval processes to protect their legitimate business interests while at the same time, having to question the propriety of costs incurred by the Regulator.
- There are models which exist which allow for a direct pass through of costs such as the Goods and Services Tax.
- However, if service providers are to be the collection agencies for government, there must be a guaranteed “pass through” of these costs and the costs they incur in acting as the collection agency. A framework which does not guarantee “pass through” amounts to a “stealth tax” whereby the service providers have no guarantee that they can pass on regulatory costs imposed by the government to those who are intended to be the ultimate beneficiaries of the regulatory framework.
- Regardless of who is the collection agency, there must exist sufficient levels of transparency and accountability measures to ensure costs are efficiently and appropriately incurred by Regulators. This includes at least the following measures:
 - The setting of budgets by an independent body such as parliament;
 - The ability for stakeholders to comment on budgets of regulators before they are approved;
 - The disclosure of sufficient information by Regulators to enable scrutiny of costs actually incurred by Regulators;
 - The ability for stakeholders to challenge the validity of costs imposed on stakeholders or the reasonableness of these costs;
 - Incentives for Regulators to ensure costs do not exceed the current levels of expenditure and that costs are kept to a minimum.
 - Most importantly however, only reasonable costs can be passed on – as per the Supreme Court case for Epic Energy.
 - Establishment costs should not be borne by industry - particularly with the number of consultants that have already been engaged by the MCE and each jurisdiction as part of this process.
 - the pipeline industry must not bear an unfair proportion of the costs.

- The APIA specifically endorses the FERC model in this respect.
- It is neither fair nor reasonable for industry to be required to pay the legal costs of actions in which the Regulator is shown to have erred, or the costs of preparation of a flawed decision; and
- It should not be assumed that the costs incurred by Regulators in carrying out all powers and functions are to be recovered, particularly the costs of Regulators in exercising enquiry functions or planning functions.

It should be noted that models already exist for ensuring that the beneficiaries of regulation should pay for its associated costs via means other than consolidated revenue (e.g. in relation to FRC Market Operation).

6. Need for effective consultation

Given the importance of this issue, there is a need for industry to be intimately involved at every stage of the process for the consideration and development of any industry levy. This is so given the potentially wide ranging and fundamental impact that any industry levy could have on the gas industry.

If stakeholders have no (or an ineffective) say in the development of this key aspect of the regime that will have a significant impact on their legitimate business interests, there is every reason to doubt the public's level of confidence in the regulatory regime. Besides the consequential impact that this will directly have on investor sentiment, it must also call into question whether the outputs that will result from the application of the legislative framework will be appropriate or aligned with the original intentions of government.

At the very least, the APIA submits that effective consultation requires:

- A costs / benefit analysis of an industry levy to be released for public comment.
- Details of the costs that are currently being incurred by regulatory institutions such as the ACCC and state based regulators, together with an estimate of the costs likely to be incurred by the proposed regulatory institutions.
- The preparation of a further paper containing a detailed outline of the possible options for implementation, incorporating constitutional legal advice as appropriate, and an outline of the preferred options with a clear definition of the roles of the relevant institutions.
- Details of all submissions to be made publicly available as soon as they are received by the MCE.

APIA would be concerned were such a fundamentally important issue to be implemented by way of Regulations in order to achieve the MCE's stated time frame for implementation of the energy reforms. The experience from the implementation of an industry levy through regulations in Western Australia is

that it has led to a regime which is fundamentally flawed and lacks any form of public confidence in its effectiveness.

RESPONSE TO SPECIFIC ISSUES IN DISCUSSION PAPER

The APIA comments on the following specific points from the discussion paper:

1. Section 2 – Background and Objectives

Subject to APIA's earlier comments about the requirement for costs to be borne from consolidated revenue, if there is a move to an industry levy, APIA endorses the principles to underpin such a proposal – ie that:

- the funding mechanisms should be simple to understand;
- the financial impact of the funding mechanism on any industry participant should be predictable and be able to be estimated by industry participants;

However, APIA seriously questions the rationale for the principle that “economic efficiency should be promoted by:

- attributable rule making and regulatory costs being borne by those industry participants who give rise to the costs;
- allocation of rule making and regulatory costs (where necessary) occurring on the basis of a metric which relates to the cause of the cost;
- where rule making and regulatory costs are fixed, rather than variable, allocations to industry participants should not create barriers to new entrants to the energy sector;
- fees (prices) for cost recovery being set on the basis of recurring rule making and regulatory expenditures; and
- fees (prices) to recover the costs of extra-ordinary and/or one-off events, such as the set-up of the AEMC and AER and appeals to arbitration or legal appeals”

2. Section 3.4 – Assigning Costs to fee components

APIA queries why it is considered appropriate to limit cost recovery to a limited part of the market. For gas transmission pipelines, end users are the largest customer base. Accordingly, to prevent costs from being recovered from this group ignores the reality that they are the most significant beneficiaries of regulation.

They must therefore be the ones that bear the costs of regulation.

Furthermore, APIA queries why it is thought to be appropriate for gas pipeline businesses to be more easily able to pass through rule making and regulatory fees which might be imposed upon them (see page 10 of the discussion

paper). The only justification for this conclusion seems to be that pipelines are heavily regulated.

This is not the case. A significant number of transmission pipelines are not regulated. Furthermore, as has been seen in Western Australia, because of the regulatory approval process, some service providers are prevented from passing on the costs of regulation.

Moreover, those pipelines that are regulated, have long term contracts in place which, in many cases, may prevent the passing on of these costs.

3. Section 5 – Case Studies

The Discussion paper outlines a number of statutory frameworks that should be investigated further as potential “models” on which to base an industry levy for the recovery of costs for the MCE and AER.

APIA considers that the outlines in respect of some of these frameworks are incomplete and before they can be seriously considered as potential models, more detailed analysis is required. As noted above however, the FERC model should be reviewed more closely for its attributes of transparency and accountability.

To assist in providing more detail in respect of particular models, the APIA provides the following comments on those models with respect to which, its members have had direct experience:

Gas Pipelines Access (Western Australia) Act 1998

This represents a highly draconian cost recovery mechanism. The Regulator (the Economic Regulation Authority) has adopted the principle that all costs should be recovered from industry but in doing so, it is not accountable to the very stakeholders who must bear the costs. Furthermore there is no requirement for transparency on the part of the Regulator. It embodies all of the principles that the APIA has urged in this submission, must be avoided. In particular:

- If a service provider seeks to challenge the validity of any costs the ERA seeks to pass on to it, the service provider is most likely faced with the prospect of having to deal with the very entity who is undertaking the regulatory approval process from which the invoice originated. This places the service provider in an awkward predicament.
- Under the Gas Access Act, an invoice that is issued is treated as a debt due and all that is required as evidence as to this fact is a certificate from the regulator. There is no independent body who is charged with assessing the validity of any invoice that the service provider may receive from the Regulator or a dispute mechanism for the service provider to use if it disagrees with any costs the regulator seeks to recover from it. This will therefore result in the service provider being placed in the invidious

position of having to refuse to pay such disputed amounts, being charged interest on these amounts by the regulator and having to wait until the regulator commences recovery proceedings before the dispute can be dealt with. This therefore means additional costs being incurred by both service providers and the regulator. One must also question who must bear the regulator's costs of such action, particularly when the service provider is vindicated in court.

- The Regulator has also refused to allow the Service Provider to pass on the regulator's costs to the users by way of an increase in the tariff. Given that it is the user who is the main beneficiary of competition policy related reforms, one must question the political motives of the government.
- Service providers have no control over a regulator's timeliness or expenditure – the only control would be exercised by the Government, which once again calls in to question the independence of the regulator. Under the Gas Access Act, the aggregate of the costs that the regulator has sought to recover from Epic Energy for example, being only the costs for work directly related to what the Regulator considers to be the regulator's assessment of the access arrangement for the DBNGP, already have exceeded \$3 million.