REVIEW OF THE NATIONAL GAS PIPELINES ACCESS REGIME

PROPOSAL FOR CONSULTATION

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Ministerial Council on Energy

NOVEMBER 2005

Ministerial Council on Energy's Proposed Response to the Productivity Commission Review of the Gas Access Regime

1. Purpose

This document sets out for consultation a proposed response for the Ministerial Council on Energy (MCE) to the Productivity Commission's review of the National Gas Access Regime. The proposed response has been prepared by MCE officials and should not be read as a settled view of Ministers.

The MCE requested at its meeting on 4 November 2005 that the proposed response be published for consultation, prior to a final MCE decision by 7 December 2005. Submissions are invited on this proposed response. Arrangements for making submissions and related consultation are available in an MCE Bulletin available on the MCE website.

The National Gas Access Regime was referred to the Productivity Commission (PC) for review in June 2003. The Council of Australian Governments has agreed that the government response to the Productivity Commission review of the national gas access regime will be made by the MCE.

The Productivity Commission Report was provided to the Federal Treasurer in June 2004, and has been published. Since that time, a further round of consultations with stakeholders on some of the key issues raised in the report has been held. In addition, implementation of other elements of the MCE's broad program of energy sector reforms has proceeded.

An important factor in responding to the Productivity Commission's Review of the Gas Access Regime is to ensure that the response in the specific context of the Gas Access Regime is integrated with the broader reforms being undertaken in the energy sector. The implementation details of these reforms, and in some cases, the direction of the reforms themselves, were proceeding concurrently and subsequent to the Commission's review.

A key element of this proposed response is the commissioning of an Expert Panel to advise on a model to achieve a common approach to revenue and network pricing across the energy market. This is intended to ensure that the currently disparate reform efforts effectively are brought together and that the MCE's goal of seamless access regulation across gas and electricity transmission and distribution is realised.

The MCE is commissioning the Panel to commence work in November 2005, and the MCE will settle a complete terms of reference for the scope of the Panel's work as part of the final decision.

The paper is organised as follows:

Section 2 provides the general background to the PC review.

Section 3 discusses the context for the MCE response, in particular the integration of the response to the PC review with the broader energy reform agenda.

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Section 4 discusses the MCE's proposed response to certain key policy issues raised by the Productivity Commission. These are:

4.1 The overall objects for the regime (pages 7 - 9).

4.2 The test for coverage under the regime and the administration of that process (pages 9 - 10).

4.3 The introduction of a light-handed regulatory option (pages 10 - 14).

4.4 Measures to enhance regulatory certainty for greenfields projects (pages 14 – 18).

Section 5 (pages 18 – 21) then describes further the further process that has been established to ensure that a national approach to access across gas and electricity transmission and distribution is realised.

Appendix 1 sets out a response to each of the Productivity Commission's detailed recommendations, consistent with this consultation paper, and Appendix 2 contains a proposed terms of reference for the Expert Panel review noted above.

2. Productivity Commission Review of the Gas Access Regime

The MCE welcomes the Productivity Commission's review of the Gas Access Regime.[1] The Commission's review highlights the impressive growth of the industry over the period since the commencement of the Regime in 1995, both in terms of its absolute size and contribution to the economy and well-being of Australians, as well as the diversity of supply sources and industry participants. However, the review has identified a number of areas where improvements to the Regime can be made in order to maximise the potential for the industry's growth and contribution.

An important finding of the review is that, notwithstanding the industry's recent impressive growth, the design and application of the regulatory regime given effect by the Regime has the potential to deter investment in the future, and changes to the Regime are justified to minimise this potential. A key concern of the Commission was to improve the certainty for investors in regulated assets and to minimise the costs of regulation, while protecting customers from the misuse of market power. These sentiments are endorsed.

The Commission made some 54 recommendations for modification to the Gas Access Regime, which covered five main themes, namely:

- the overarching guidance provided to the regulator;

[1] The Gas Access Regime (the "**Regime**") comprises the *Natural Gas Pipelines Access Inter-Government Agreement* of 7 November 1997 (the "**Agreement**"), the Gas Pipeline Access Acts of the Commonwealth, States and Territories, and the Gas Pipelines Access Law (the "**GPAL**") which includes the National Third Party Access Code for Natural Gas Pipeline Systems (the "**Gas Code**"). The Law and the Code are statutory instruments, comprising Schedule 1 and Schedule 2 to both the *Gas Pipelines Access (South Australia) Act 1997* and the *Gas Pipelines Access (Western Australia) Act 1998*.

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- the scope of the facilities covered by the Regime – referred to in the Regime as coverage – and the related issue of the form of regulation that is applied to ‘covered’ pipelines;

- the specific guidance provided to the regulator on the process to be followed when assessing prices, and the specific guidance to regulators on pricing matters;

- several high-level regulatory design issues, such as the character of the regulator’s discretion, its power to obtain information and the avenues available to appeal a regulator’s decision; and

- a number of ancillary regulatory matters, such as the requirements for contracts with affiliate parties to be approved.

3. Context for the MCE’s Response – the Energy Reform Agenda

The review undertaken by the Commission – and the response to that review– sits within a broader set of reforms being pursued in the energy sector. The MCE’s December 2003 report to COAG, *Reform of Energy Markets*,[2] identified a number of specific objectives for the reform program, the most relevant of which to the gas reform agenda included to:

- strengthen the quality, timeliness and national character of **governance** of the energy markets, to improve the climate for investment;

- streamline and improve the quality of **economic regulation** across energy markets, to lower the cost and complexity of regulation facing investors, enhance regulatory certainty and lower barriers to competition; and

- further increase the penetration of **natural gas**, to lower energy costs and improve energy services, particularly in regional Australia, and reduce greenhouse emissions.

The MCE’s December 2003 report contained specific reforms to the governance arrangements for the energy sector, and recommended further activities for the achievement of the other objectives, including an in-principle agreement to develop a national approach to energy access under the *TPA*, covering electricity and gas transmission and distribution.

The MCE’s report – including the objectives set out above and the specific recommendations – was endorsed by First Ministers and formed the basis for the COAG *Australian Energy Market Agreement* on 30 June 2004.[3] This inter-governmental agreement set out the timetable for the progressive introduction of

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2 Ministerial Council on Energy Report to the Council of Australian Government, *Reform of Energy Markets*, 11 December 2003.

3 Council of Australian Governments, *Intergovernmental Agreement on an Australian Energy Market*, 30 June 2004.

the new governance arrangements for the sector from mid 2005.[4] In broad terms, once fully implemented, the new governance arrangements will comprise:

- *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 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* – 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.

Consistent with the change in the governance arrangements for economic regulation in the industry, a new legal structure has also been agreed. In particular, the legal framework for economic regulation in both the electricity (NEM) and gas is 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;

- **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.

The application of this framework to the gas sector will require consideration of where the provisions currently split between the GPAL and the Access Code should reside. It is expected that a number of provisions in the present Code – namely, those provisions that confer or impose significant substantive rights or obligations on persons or those that confer or impose powers, privileges and duties on decision makers that affect participants in the gas sector in a significant way – would be elevated to the new law. This matter is returned to below.

The MCE further agreed to expand the gas related elements of the energy reform program to address both short and longer term gas market development and infrastructure needs, as explained in a supplement to its December 2003 report.[5] This Supplementary Report identified three priority areas for reform in the gas industry, which were to:

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[4] Under the Agreement, WA is not committed to transferring functions to the AER related to gas, and to the AER and AEMC relating to electricity. WA is committed to conferring functions to the AEMC relating to the making of Gas Access Rules.

[5] Ministerial Council on Energy: *Expanded Gas Program*, supplement to the MCE Report to COAG on Reform of Energy Markets,19 May 2004.

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- investigate measures to accelerate the development of a reliable, competitive and secure natural gas market;

- develop a Gas Emergency Response Protocol taking account of lessons learned from the Infrastructure Taskforce report into the Moomba incident of January 2004; and

- consider and respond to the Productivity Commission's review of the Gas Access Regime in the context of its in-principle commitment to develop a national approach to energy access under the *Trade Practices Act 1974*, covering electricity and gas transmission and distribution.

Work on each of the separate reform measures discussed above is proceeding. MCE has agreed a Gas Emergency Response Protocol as a basis for managing major gas shortages. The MCE has also agreed to a set of principles for the development of the gas market, and arrangements to implement those principles are underway.

With respect to energy access, other reform efforts are proceeding. A new National Electricity Law already is in operation and sets out the key rights, obligations and powers of the various parties with respect to access regulation. In addition, the AEMC is required under that law (section 35) to determine new rules applicable to setting regulated prices for electricity transmission, and has already commenced its consultations for that task. In addition, the national framework for energy access for electricity and gas distribution and retail (other than retail pricing) is being developed, and a consultant's paper to inform further development of the framework was released in October 2005 and is available on the MCE website (mce.gov.au).

The MCE accepts the broad themes emerging from the Commission's report. However, a critical issue now is to ensure that the reforms being pursued to the gas industry are integrated with the reforms being pursued to the remainder of the energy sector. A particular priority for the MCE is to ensure that the currently separate reform processes for energy access are brought together to ensure that the MCE's goal of a seamless national approach to energy access across electricity and gas transmission and distribution is realised.

To this end, the MCE will commission a panel of experts to review and report upon the issues that need to be addressed to implement this national approach to energy access covering both gas and electricity transmission and distribution. This expert review will include an assessment of the scope for the law and statutory rules to be common across all sectors, and the matters where technology, market or other factors may necessitate distinctions. The commissioning of such a review implies that the final position on many of the Productivity Commission's more detailed recommendations will await future processes. Further detail on the work the MCE will commission, the issues the MCE expects it to cover and its time lines are set out in section 5 below.

That said, however, the Productivity Commission has considered and made recommendations on a number of important matters for which it is appropriate for the MCE to reach a concluded view in advance of the further work described above. The four matters that have been identified are:

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- the overall objective for the regime;
- the criteria that are to be applied to test the facilities that should be regulated and the administrative arrangements for that assessment;
- whether an option for light-handed regulation should be included within the regime and, if so, the form of that regime; and
- measures to promote greenfield projects.

The MCE's conclusions on these matters are set out in turn below.

The MCE notes that the Commission's report only addressed *price regulation* issues in any detail – and largely confined its recommendations to these matters. As discussed above, the reforms currently being pursued for the gas industry (as part of the wider energy sector reforms) are much wider, and include as a key element the consideration of options for increasing the development of a reliable, competitive and secure natural gas market. Accordingly, the Commission's review of the Regime comprised only a subset of the reforms being considered for the gas sector.

4. Final Position on Productivity Commission Recommendations

4.1 Insertion of an Objects Clause for the Regime

The Commission observed that the Regime as currently drafted lacks clarity about its objectives. It noted that there is no overarching objects clause, and the Regime requires regulators to have regard to a complex set of factors and principles, the potential uncertainty in which was brought to a head in the decision by the Supreme Court of Western Australia on the Epic matter.[6]

One of the Commission's key recommendations was to introduce an overarching objects clause, namely:

> *to promote the economically efficient operation and use of, and economically efficient investment in, the services of transmission pipelines and distribution networks, thereby promoting effective competition in upstream and downstream markets*

The Commission's recommendation for the need for an overarching objects clause is endorsed. It is agreed that the inclusion of an overarching objects clause is highly desirable to clarify the policy intent of the regime; guide and improve the accountability of all decision makers; provide greater certainty to service providers and access seekers about possible regulatory intervention; and promote national consistency (both across jurisdictions and between access regimes).

However, the MCE does not consider that the objects clause as proposed by the Productivity Commission is the most appropriate.

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[6] *Re Dr Ken Michael AM; Ex Parte Epic Energy (WA) Nominees Pty Ltd & Anor* (2002) 25 WAR 511.

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In particular, given the MCE's key objective of promoting a seamless approach to energy access across the energy sector, it has decided that a objects clause mirroring that already contained in the NEL for the electricity sector would be more appropriate, namely:

> *The objective of the gas access regime is to promote efficient investment in, and efficient operation and use of, natural gas pipeline services for the long term interests of consumers of natural gas with respect to price, quality, reliability, safety and security of supply of natural gas.*

It is noted that this formulation for the objects clause retains economic efficiency as the key criterion, consistent with the Commission's recommended version. However, the refinements to the Commission's objects clause:

- ensure consistency with the access regime in the electricity sector;
- draw the regulator's attention explicitly to the important non-price elements of the service that are valued by customers, such as the reliability and security of supply;
- recognise that competition is only a means to an end rather than an end in itself, and so appropriately removes the contrary implication; and
- highlight the importance to First Ministers of ensuring that the regulatory regime delivers benefits to customers – in particular, by recognising that the end-point sought from the regime is to deliver benefits to customers – consistent with the objectives of the Australian Energy Market Agreement.

The MCE notes that a number of parties have expressed concern that adopting an objects clause for the gas sector that directs decision makers to consider the benefits provided to customers may lead to decisions being skewed in favour of customers to the detriment of investors and investment in pipelines. The MCE notes, however, that its chosen objects clause refers decision makers specifically towards the long term implications of decisions, and also emphasises the importance of non-price outcomes – such as reliability and security (in turn, a function of investment) and is confident that its chosen objects clause will promote decisions that are appropriately balanced as between short term and long term outcomes.

The MCE also notes that one of the Productivity Commission's concerns was to ensure consistency between the objects clause that is included in the National Access Regime and those contained in sectoral regimes – which was reflected in its recommendation. The MCE considers, however, that consistency across the energy sector is a higher priority (given the strong commercial linkages within the energy sector), which supports its position. It also notes that Governments considered carefully the objects clause for the electricity sector and enacted the current clause, notwithstanding the different formulation in the National Access Regime.

The Productivity Commission also made a number of recommendations to improve the clarity of the other high-level guidance that is provided to decision makers, including to delete the preamble currently contained in the GPAL and to remove the majority of the factors that regulators are required to consider when assessing an access arrangement (section 2.24) and arbitrating an access dispute (section 6.15).

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Deletion of the preamble is agreed, and it is noted that the preamble's role would be superseded by a new objects clause. Regarding the remaining matters, while the MCE notes that many of these recommendations would appear sensible, the form of such guidance would be expected to be common across the energy sector and so would appropriately be considered as part of the development of the national approach to energy access discussed further in section 5.

The objects clause in the new National Gas Law will read as follows:

"The objective of the gas access regime is to promote efficient investment in, and efficient operation and use of, natural gas pipeline services for the long term interests of consumers of natural gas with respect to price, quality, reliability, safety and security of supply of natural gas."

The current Preamble in the Gas Pipelines Access Law will not be carried over into the new National Gas Law.

4.2 Coverage test and administration

Coverage Test

One of the Productivity Commission's recommendations was to amend the criteria that are applied to test whether a pipeline should be regulated (covered) so that only those for which coverage would generate a *material* increase in competition in a related market could be covered. The remaining criteria would remain unchanged.

The revision to the coverage test recommended by the Commission is endorsed, noting that the adoption of this test will align the coverage criteria for gas pipelines with the criteria for declaration of services under Part IIIA of the *Trade Practices Act 1974*. It is noted that the adoption of this change should ensure that only pipelines with substantial market power will meet the test for coverage, thus lessening the chances that formal price control is imposed where it is not absolutely necessary.

The MCE also agrees with the Commission's recommendation to ensure that the scope for 'forum shopping' between the gas access regime and national access regime (through the submission of an undertaking to the Australian Competition and Consumer Commission under Part IIIA of the *Trade Practices Act 1974*) should be removed. It is noted that the Commonwealth Government agreed to an identical recommendation in its response to the Commission's earlier review of the National Access Regime and has already introduced legislation to amend the Trade Practices Act 1974 to remove the possibility of 'forum shopping' between the National Access Regime and Gas Access Regime.

The MCE notes that whether there should be a formal test and process for assessing whether an infrastructure asset is regulated (and for permitting an asset that no longer meets the test to be deregulated) is one current inconsistency between the electricity and gas sectors. While governments have adopted a policy position that electricity transmission assets should continue to be regulated, whether a formal coverage test should extend to electricity distribution is a matter that the further review discussed in section 5 may cover.

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The coverage test for gas transmission and distribution pipelines will be aligned with the coverage test in Part IIIA of the Trade Practices Act 1974.

Administration of the Coverage Test

The Productivity Commission concluded that the current administrative arrangements for coverage, whereby the bodies that recommend or decide upon coverage are separate to the body that ultimately will regulate a pipeline if covered, should remain. The MCE endorses this recommendation.

However, the MCE notes that a further key element of the energy reforms has been the creation of the AEMC as a body that monitors and advises upon the development of energy markets – including advice upon the degree of competition present – and is able to develop the critical mass of this type of expertise that has not been possible with the existing institutions. As the AEMC in effect will develop an expertise to assess coverage matters, the MCE has concluded that it would be appropriate to vest in the AEMC the role of advisor of coverage matters in the future. The relevant Minister will remain as ultimate coverage decision maker. If the coverage criteria are set out in the Law, then the intended separation between rule making and rule application is preserved.

It is noted that another key theme of the broader energy reform agenda is to create a greater separation between rule making and rule application or enforcement. In order to preserve this separation, the criteria and procedure for coverage assessments will be transferred to the new National Gas Law and hence not able to be changed by the AEMC.

The AEMC will be the coverage recommendation body (taking over the role currently performed by the National Competition Council) and the criteria and procedural requirements for coverage assessments will be included in the new National Gas Law.

4.3 Introduction of a light-handed form of regulation

A central element in the Productivity Commission's report – and the topic of most interest in subsequent consultations – was a recommendation to introduce a more 'light-handed' form of regulation for covered gas pipelines as an alternative to formal price control (up-front regulatory assessment of prices) currently in place under the Code. A key concern of the Commission was to provide a further option for regulation where assets are in a transition towards effective competition, as well as to ensure that the costs of regulation are minimised and appropriate for the degree of market power present.

It is important to understand that this section relates to the form of regulation for pipelines that have sufficient market power to pass the new higher threshold for coverage. The ability will remain for pipelines to seek complete deregulation where they are subject to emerging competition – as several major pipelines in south east Australia have achieved under the previously lower threshold for coverage.

The key features of the Productivity Commission's model were as follows:

- the light-handed regulatory regime would comprise a monitoring regime combined with binding arbitration in the case of disputes (which would be sufficient to be accredited as an effective access regime under the National Access Regime) and several other existing regulatory measures:

  - the monitoring regime would require publication of financial information (revenue, expenditure, returns), operation information, information on access negotiations and information on dealings with associates;

  - the existing anti competitive conduct provisions (preventing or hindering access) in the Gas Pipeline Access Law would apply, as well as a modified version of the ring fencing requirements set out in the Gas Code;

  - whether the light-handed regime would apply would be determined at the time of coverage and the decision to impose the light-handed regime could not be re-opened for 5 years:

  - the light-handed regime would operate as the default and the up-front regulatory determination of prices would only be imposed if a net benefits test was satisfied;

  - after 5 years, the regulator (but no one else) could apply for the upfront regulatory determination regime.

An alternative model for light-handed regulation (based upon the regime applicable to airports) was also exposed to wider consultation, which comprised the following key features:

- the light-handed regime would be a price monitoring regime only (that is, no ability to seek binding arbitration), with the information disclosure requirements similar to that proposed for the Productivity Commission model;

- the light-handed regime would apply to all pipelines that passed a simple threshold (for example, a threshold based upon the materiality of the pipeline) with the existing coverage process (including the revised test) to determine whether formal price control should be imposed; and

- a number of measures were proposed for transitioning the monitoring regime and for addressing the circumstances of greenfields projects.

The distinguishing features of the alternative regime were that the regulatory regime would be more light-handed than proposed by the Productivity Commission (involving monitoring only), but apply to a wider class of pipelines.

The MCE notes that there are a number of concerns with the light-handed regime that was proposed by the Productivity Commission. While much of the detail of the regime remained to be developed, it notes that the regime would be unlikely to be truly light-handed if it was sufficiently robust to be deemed an effective access regime under the Trade Practices Act 1974. It also notes concerns with the potential increase in the complexity of the coverage process if both coverage and the form of regulation are decided simultaneously. In addition, the MCE notes concerns that the

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degree of market power required for pipelines to be covered may imply that a truly light-handed regime would be inappropriate for pipelines that are covered.

The MCE also notes the concerns with the alternative model that was proposed. Most notably, with the possibility that the proposal may result in a net increase in the quantum of regulation applied to the industry (although whether regulation did increase would depend upon whether the monitoring regime permitted currently covered pipelines to have coverage revoked).

The MCE agrees with the Productivity Commission's view that the current approach under the Regime whereby pipelines are either subject to formal price control, or completely deregulated, does not provide a satisfactory means of dealing with all potential situations, including with the emergence of competition in the provision of formerly monopoly services, such as has been observed in the south east Australian pipeline network. The MCE also considers it essential for the costs of regulation to be minimised. Accordingly, the MCE has decided to introduce a light-handed regulatory regime. This regime will preserve many of the features of the Productivity Commission's proposed model, but address the shortcomings that were identified.

The key features of the model that will be introduced, and its relationship to the remainder of the regime, are as follows:

- there would be two regulatory options available for covered pipelines, namely:
    - a continuation of the current approach, whereby the regulator would undertake up-front, periodic assessments of reference tariffs and other associated elements; and
    - a light-handed option, under which there would be no upfront assessment of reference tariffs, but rather would comprise monitoring with dispute resolution as a fallback (this option is described more fully below);
- the decision about the form of regulation would be made by the AER, and reflect an assessment of the relative costs and benefits of applying the different regulatory options to the particular pipeline. The AEMC will be requested to develop clear criteria about the conduct of this cost-benefit assessment (the role of the AEMC is elaborated upon further below);
- the timing of the decision about the form of regulation that is appropriate for a particular pipeline would be as follows:
    - where a pipeline is *already covered* (and so has approved reference tariffs in place), a decision to switch to the light-handed regime could occur at any time, and would have effect after the expiry of the current access arrangement (so that, under the light-handed option, there would be no requirement to submit a revised access arrangement for assessment); and
    - where a pipeline is *covered for the first time*, the decision about the form of regulation would be made prior to the submission of a proposed access arrangement (so that, under the light-handed option, there would be no requirement to submit an access arrangement for assessment);

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- the key features of the light-handed regime referred to above would be as follows:
    - the pipeline owner would be free to negotiate prices and other terms and conditions with access seekers, with the Gas Code's existing dispute resolution procedures operating as a fallback;
    - the existing other regulatory measures would continue to operate – namely, the ring fencing obligations, the requirement not to hinder access and the provisions related to contracts with associates;
    - disclosure of information as proposed by the Productivity Commission, but with the disclosure requirements able to be tailored to the specific circumstances of each pipeline to ensure that compliance costs are minimised; and
    - as noted above, the existing coverage process would remain, and hence continue to permit pipelines that are subject to increasing competition to seek complete deregulation, as has been the case already for a number of important pipelines in South East Australia.

Importantly, this model will preserve the key theme of the Productivity Commission's proposal, which is to ensure that regulatory reviews of prices are only undertaken where the benefits exceed the costs and, in parallel, to maximise the opportunities for commercially negotiated arrangements. The refinements to the model for light-handed regulation proposed by the Productivity Commission are that:

- the decision on the application of light-handed regulation would be separated from coverage, thus ensuring that the complexity of coverage assessments would not increase;
- the existing Gas Code dispute resolution procedures would be utilised rather than relying upon new and separate procedures, thus minimising concerns about the ability for the regime to be certified as effective under the Trade Practices Act 1974;
- the disclosure requirements would be able to be tailored to suit the individual circumstances of a particular pipeline, and so minimise compliance costs (especially for small pipelines); and
- the regulator (AER) would apply the Rules developed by the AEMC to decide the form of regulation that is appropriate for a particular pipeline.

As noted above, the AEMC will have a central role in the light-handed regime. In particular, the AEMC will be requested to develop Rules to govern:

- the AER's assessment of which regulatory option should apply – it is intended that these Rules will provide the AER with clear criteria about the conduct of the assessment of the relative costs and benefits of the alternatives implementing the light-handed option; and

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- the new information disclosure requirements of the new light-handed regime – which will cover both the information disclosure requirements as well as the necessary procedural and related requirements. An important matter for the AEMC in this regard will be to ensure that the scope of the disclosure requirements can reflect the particular circumstances of individual pipelines.

The development of clear Rules on these matters will provide certainty to stakeholders and ensure an appropriate separation between rule-making and enforcement. In line with its role more generally, the AEMC also will be responsible for monitoring the effectiveness of these new Rules over time and deciding upon whether any proposed amendments would be appropriate.

A new light-handed regulatory option will be introduced that has the following key features:

the pipeline owner would be free to negotiate prices and other terms and conditions with access seekers, with the Gas Code's existing dispute resolution procedures operating as a fallback;

the existing other regulatory measures would continue to operate – namely, the ring fencing obligations, the requirement not to hinder access and the provisions related to contracts with associates;

disclosure of information, as proposed by the Productivity Commission would be required, but with the disclosure requirements able to be tailored to the specific circumstances of each pipeline to ensure that compliance costs are minimised; and

the existing coverage process would remain, and hence continue to permit pipelines that are subject to increasing competition to seek complete deregulation.

The AER will apply Rules developed by the AEMC to decide which of the options is appropriate for a particular pipeline. This assessment will occur at any time (and take effect at the end of an access arrangement period) for a pipeline that is already covered, and prior to the submission of an access arrangement for a newly covered pipeline.

The AEMC will be requested to develop more detailed Rules governing the AER's decision of whether to waive the requirement for further access arrangement reviews (i.e. to set out more clearly the conduct of the cost-benefit assessment), as well as Rules governing the operation of the new information disclosure regime.

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4.4 Enhancing regulatory certainty for Greenfields projects

Consistent with the MCE's objective to encourage the penetration of natural gas, the MCE considers that the creation of an appropriate climate for maximising the potential for investment in greenfield gas pipeline projects is a priority issue for the energy sector reforms. A strong, interconnected gas transmission network is essential to the reliable supply of gas and links with more remote gas fields will become essential over the medium term as demand grows and supply from closer fields diminishes.

The MCE accepts the findings of the PC review of the Gas Access Regime that greater certainty about the coverage status of a proposed pipeline would reduce the regulatory risk for proposed greenfield gas pipelines and therefore encourage further investment. The MCE notes the concerns that the cost associated with regulatory compliance could affect investment, and also that regulation (or its possibility) could complicate the negotiation of foundation contract arrangements, and possibly create incentives for pipelines to be undersized or deferred.

The MCE has therefore decided to implement two measures specifically to improve regulatory certainty and encourage investment in greenfield gas pipelines.

Measure 1: Binding No Coverage Ruling

The MCE has agreed to adopt recommendation 9.1 of the Commission's review of the Gas Access Regime. The proponent of a proposed greenfield gas transmission pipelines or distribution network will be able to apply to the AEMC for an upfront coverage assessment. The AEMC will be empowered to conduct such assessments and make a recommendation to the designated Minister in respect of proposed greenfield gas pipelines. Upon receiving an AEMC recommendation that the proposed pipeline does not meet the coverage criteria, the designated Minister may provide a binding 15 year no coverage ruling in respect of the pipeline.

The process for the AEMC to arrive at its recommendation will be the same as the present coverage process. The binding ruling would preclude coverage of the pipeline over the initial 15 year period from the commencement of commissioning, irrespective of whether market conditions change (except in the limited circumstances as recommended by the Commission).

If the designated Minister decides the proposed pipeline meets the coverage criteria taking into account the recommendation of the AEMC and therefore does not provide a binding no coverage ruling, the pipeline proponent may:

- seek guidance on the form of regulation to be applied and progress coverage in response to that advice; or
- may build and operate the pipeline in the market uncovered (in this case, the pipeline may be subject to a future coverage application); or
- may make an application under Measure 2.

Measure 2: Price Regulation Holiday

The MCE recognises that the coverage assessment process followed by Ministerial decision on a binding ruling may not be a sufficiently timely process to provide regulatory certainty for some gas pipeline projects. This may be due to their size and/or complexity or the needs of the market to be supplied or timing constraints on finalising contractual and financing arrangements. To ensure that the regulatory regime does not inhibit such pipelines proceeding to financial close the MCE has decided to implement a 15 year price regulation holiday for proposed gas pipelines as an additional option to the first measure described above.

A pipeline qualifying for a price regulation holiday would not be subject to any upfront assessment as to whether it would meet the coverage criteria. It would be

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subject to the Gas Code requirements except in respect of price regulation. That is, the proposed pipeline would still be subject to regulation, but only in respect of the non-price access provisions. This would maintain the price regulation holiday within the framework of the gas access regime.

The proponent of a proposed gas pipeline would apply directly to the relevant Minister for a 15 year price regulation holiday. If granted, the price regulation holiday would also apply from the date on which gas commences to flow.

Consistent with the above, a pipeline granted a 15 year price regulation holiday would be required to make public a policy that the pipeline would offer non-discriminatory pricing for similar reference services and be required to comply with the non-price provisions of the current Gas Code (as converted into the National Gas Law and Rules), including:

- Content of an Access Arrangement (except Reference Tariffs and Reference Tariff Policy, and Determining Reference Tariffs through a Competitive Tender Process);
- Ring Fencing Arrangements;
- Information and Timelines for Negotiation;
- Dispute Resolution in relation to non-price matters;
- General Regulatory and Miscellaneous Provisions to the extent that they do not relate to pricing matters.

Once a price regulation holiday is granted, the service provider would be required to submit to the AER an access arrangement covering the above non-price access provisions. The AER would exercise its compliance powers and functions in respect of the non-price access provisions.

At any time during the 15 year price regulation holiday period, the service provider could apply for a coverage assessment and binding no coverage ruling from the designated Minister (Measure 1 above). If the assessment recommended no coverage and such a ruling were granted, it would apply for the balance of the 15 years from the date on which gas flow first commenced, and the non-price access obligations would cease to apply. If the assessment recommended coverage and such a ruling was therefore not granted, the 15 year price regulation holiday would continue.

At the end of the 15 year price regulation holiday period, the pipeline will continue to be uncovered, subject to any subsequent coverage application.

A key component of the new greenfields pipeline regulatory holiday regime will be the criteria for determining whether a particular project qualifies for the holiday, and the process under which an application for the holiday is assessed. The MCE's detailed proposals in this regard are discussed for transmission and distribution in turn.

Greenfield Criteria for Transmission Pipelines

A proponent of a transmission pipeline project which has not yet commenced operations or an extension (but not a capacity expansion) of an existing transmission

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pipeline which has not yet commenced operations will be able to apply to the Relevant Minister in writing for a decision on whether the pipeline or part of the pipeline is a Greenfield Pipeline. The Relevant Minister will be the same Minister who would normally decide on the coverage of the pipeline.

The Relevant Minister would consider the application and make a decision within 28 days of receiving an application and may publish non-confidential parts of an application on the AEMC website. The Relevant Minister would be able to declare the pipeline to be a Greenfield Pipeline if:

a) it would not already be covered by an existing access arrangement; and
b) the pipeline is likely to be classified as a transmission pipeline; and
c) where the proposed pipeline directly supplies a market that is already served by natural gas, the pipeline must be owned by entities that are independent from at least one transmission pipeline serving that market.

For the purpose of deciding (c):

- the transmission pipeline would be considered to supply a market directly when it does not need to travel through another transmission pipeline to reach that market; and
- the market in question must be likely to contribute a significant proportion of the pipeline's revenue which would generally be greater than 30 percent of the projected revenue of the pipeline project; and
- the concept of independence would not include a pipeline owned by the same company, 'related body corporate' as understood by s. 50 of the *Corporations Act 2001* or an 'associated entity' as understood by s. 50AAA of the *Corporations Act 2001*.

If a pipeline was later classified as a distribution pipeline despite a decision that it was likely to be classified as transmission, it would remain a Greenfield pipeline.

Greenfield Criteria for Distribution Pipelines

A proponent of a distribution pipeline project which has not yet commenced operations will be able to apply to the Relevant Minister in writing for a decision on whether the pipeline or part of the pipeline is a Greenfield Pipeline. The Relevant Minister will be the same Minister who would normally decide on the coverage of the pipeline.

The Relevant Minister would consider the application and make a decision within 28 days of receiving an application. The Relevant Minister may publish non-confidential parts of an application on the AEMC website. The Relevant Minister would be able to declare the pipeline to be a Greenfield Pipeline if:

a) it would not already be covered by an existing access arrangement; and
b) the pipeline is likely to be classified as a distribution pipeline; and
c) it will deliver gas to a new market for natural gas (such as a town or city that currently does not have access to natural gas); and

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d) is not an extension or capacity expansion of an existing distribution system (for the avoidance of doubt, the linking of new customers within an area where customers are already connected to a distribution system would be considered an extension or capacity expansion); and
e) is in an area of a jurisdiction which the relevant energy Minister has designated as open for Greenfield Pipelines.

If a pipeline was later classified as a transmission pipeline despite a decision that it was likely to be classified as distribution, it would remain a greenfield pipeline.

The option for new greenfields pipeline proponents to seek a binding ruling that a pipeline does not meet the coverage test will be introduced. The process will mirror the process for coverage. If a pipeline is found not to meet the coverage test, the exemption from coverage will remain for 15 years after the pipeline commences operation, irrespective of whether market circumstances change.

The option of an exemption from price regulation for greenfield pipelines will be introduced. Greenfield pipelines will be defined as those that:

- are a new gas transmission pipeline or a distribution network, or an extension (but not a capacity expansion) of an existing transmission pipeline; and

- are not covered by an existing access arrangement; and

- in the case of distribution pipelines they deliver gas to a new market and are in an area designated by the State or Territory Minister for Greenfield pipelines; and

- in the case of transmission pipelines where the proposed pipeline directly supplies a market that is already served by natural gas, the pipeline must be owned by entities that are independent from at least one transmission pipeline serving that market.

Greenfield pipelines will remain subject to the non-price elements of the regime (including the requirement to have non-price elements of an access arrangement approved). At the expiration of the exemption period, the pipeline will continue to be uncovered, but the option of coverage applications will be available.

5 Development of a National Approach to Energy Access

As described already above, a key objective for the MCE is to create a seamless, national approach to energy access under the *Trade Practices Act 1974*, covering electricity and gas transmission and distribution. The MCE notes that there is a substantial degree of commonality between the investors across many of the different regulated energy infrastructure, as well as a substantial degree of commonality in the participation in the contestable segments of the energy sector. In the face of this convergence of participation across energy, the benefits of commonality in the regulatory arrangements are tangible.

While COAG already has agreed to replace the numerous state, territory and national regulators with a single regulator (the AER), to create a single entity for rule making across energy sectors (the AEMC) and create a single entity responsible government policy (the MCE), the harmonisation of institutions alone will not create a consistent and seamless approach to regulation across the energy sector. Rather, to the extent

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practicable, a common set of legal provisions (that is, the law and statutory rules as described above) across electricity and gas transmission and distribution across jurisdictions is required. The benefits expected from such a seamless approach include:

- reducing the potential for regulatory decisions (and the results flowing thereto) to distort patterns of investment across Australia and across the energy sector (noting that the increasing prominence of gas-fired generation is raising the linkages between the sectors);

- reducing the compliance costs of participants in competitive markets (such as retailers), most of whom operate across jurisdictions and energy sources, and for whom economic regulatory decisions are a key concern; and

- reducing the compliance costs of investors in regulated infrastructure, many of whom also invest across jurisdictions and energy sources.

A number of the energy market reforms that already have been undertaken or are currently proceeding are directly relevant to access regulation in the energy sector. The new National Electricity Law puts in place (amongst other things), the legal framework for 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. In addition, the MCE has commenced work on examining the issues associated with extending a national framework for energy access to electricity and gas distribution and retail (other than retail pricing), including the release of an Issues Paper in August 2004.

As discussed already, the implementation of the new legal and institutional framework for the gas industry requires further work to convert the existing Gas Pipelines Access Law and Gas Code into the new National Gas Law and National Gas Rules. In addition, the new independent rule-making framework will require a transfer of a number of elements currently included within the Gas Code into the Law, as well as decisions about the types of new high-level, legislative constraints should apply to the AEMC as well as the AER.

The Productivity Commission has made a number of specific recommendations for changes to the Gas Code as it currently stands, addressing matters such as the detailed criteria to be applied to the development and assessment of regulated prices, as well as the procedural requirements for regulatory processes. In addition, the Productivity Commission has also made a number of findings or recommendations on high-level policy issues, such as the appropriate information gathering powers for regulators and the scope of the regulator's decision (including whether a legal bias should exist in favour of the regulator accepting a proposal). Notwithstanding the merit in many of the Productivity Commission's recommendations, substantial inconsistency exists currently between the access regimes applying for electricity and gas and, for electricity, between transmission and distribution. Implementing the Productivity Commission's recommendations will not remove this inconsistency and deliver a seamless, national approach to energy access under the *Trade Practices Act 1974*.

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Accordingly, the MCE will commission a review by a panel of experts to provide the MCE with specific advice on the issues that need to be addressed and the steps that need to be taken to develop and implement a seamless, national approach to energy access under the *Trade Practices Act 1974*, having regard to the reform efforts already underway (including the Productivity Commission's Review of the National Access Regime).

The specific task for the expert review will be to provide advice on the model legislative provisions and the model contents of the statutory rules for a new, seamless, national approach to energy access. In undertaking this review, a key issue will be to identify the scope for the law and statutory rules to be common across all sectors, and to identify those areas where the technology, market circumstances or other factors may necessitate distinctions between the sectors. Some of the key issues of substance that will be considered include the appropriate scope of the AER's information gathering powers, and the criteria that a regulator would need to satisfy when assessing proposed charges (including the relative merits of creating a legal bias in favour of the regulator accepting the proposal from a regulated entity). In addition, the panel will be asked specifically to consider whether there are alternative approaches to price regulation that may impose fewer costs than the current 'building block' approach while maintaining its effectiveness, including the possible role of 'total factor productivity' trends and other relevant factors to inform the regulator's assessment of trends in prices.

In undertaking the review, the panel will be required to 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;

- 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 recommendations and findings of the Parer Review;

- the Gas Pipelines Access Law and the current Gas Code;

- the National Electricity Law and the current National Electricity Rules;

- the work undertaken by the MCE on extending a national framework for energy access to electricity and gas distribution and retail (other than retail pricing); and

- the AEMC's current review of the rules for the economic regulation of transmission.

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The panel will comprise of four members – an economist, a regulatory expert, a lawyer and eminent chair – and the chair of the AEMC will be invited to participate as an observer. The panel will be required to release an issues paper for consultation with interested parties, and provide a report to the MCE in time to meet the MCE timetable for the development of the national gas legislation in 2006.

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5.1	***The following overarching objects clause should be incorporated into the Gas Access Regime, with the wording consistent with the Australian Government's proposed objects clause for the national access regime:*** *To promote the economically efficient operation and use of, and economically efficient investment in, the services of transmission pipelines and distribution networks, thereby promoting effective competition in upstream and downstream markets.*	• MCE will adopt an overall objects clause that mirrors that in the National Electricity Law, namely: *The objective of the gas access regime is to promote efficient investment in, and efficient operation and use of, natural gas pipeline services for the long term interests of consumers of natural gas with respect to price, quality, reliability, safety and security of supply of natural gas.*
5.2	***For decisions about coverage, the form of regulation and regulated access terms and conditions, the relevant decision maker should be explicitly guided by the overarching objects clause.***	• MCE accepts this recommendation.
5.3	***With the implementation of recommendation 5.1, the following objectives in the preamble to the existing legislation and the related objectives in the introduction to the Gas Code should be deleted:*** ***(a) facilitates the development and operation of a national market for natural gas*** ***(b) prevents abuse of market power*** ***(c) promotes a competitive market for natural gas in which customers may choose suppliers, including producers, retailers and traders*** ***(d) provides for rights of access to natural gas pipelines on conditions that are fair and reasonable for the owners and operators of gas transmission and distribution pipelines and persons wishing to use the services of those pipelines*** ***(e) provides for the resolution of disputes.***	• MCE accepts this recommendation.
5.4	***The following elements of s.2.24 of the Gas Code do not provide necessary guidance to regulators when assessing access arrangements and should be deleted:*** ***(a) the Service Provider's legitimate business interests and investment in the Covered Pipeline*** ***(d) the economically efficient operation of the Covered Pipeline*** ***(e) the public interest, including the public interest in having competition in markets (whether or not in Australia)*** ***(f) the interests of Users and Prospective Users*** ***(g) any other matters that the Relevant Regulator considers are relevant.***	• MCE accepts the concept behind this recommendation. The redundant and conflicting objectives in clause 2.24 will not be included in the drafting of the equivalent sections of the National Gas Law. The Expert Panel (see recommendation 7.1) will also consider the drafting of the equivalent provisions to ensure they are consistent with their recommendations on economic regulation.

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5.5	***The following elements of s.6.15 of the Gas Code do not provide necessary guidance to arbitrators when arbitrating disputes over access arrangements and should be deleted:*** ***(a) the Service Provider's legitimate business interests and investment in the Covered Pipeline*** ***(b) the costs to the Service Provider of providing access, including any costs of extending the Covered Pipeline, but not costs associated with losses arising from increased competition in upstream or downstream markets*** ***(c) the economic value to the Service Provider of any additional investment that the Prospective User or the Service Provider has agreed to undertake*** ***(d) the interests of all Users*** ***(g) the economically efficient operation of the Covered Pipeline*** ***(h) the benefit to the public from having competitive markets.***	• MCE accepts the concept behind this recommendation. The redundant and conflicting objectives in clause 6.15 will not be included in the drafting of the equivalent sections of the National Gas Law. • The Expert Panel (see recommendation 7.1) will also consider the drafting of the equivalent provisions to ensure they are consistent with their recommendations on economic regulation.
5.6	***An additional factor should be added to s.6.15 of the Gas Code, as follows:*** ***In the event of a dispute about the price of access to a non-reference service, the arbitrator should be guided by the pricing principles in s.8.1 of the Gas Code (as revised by recommendation 7.1).***	• This matter will be considered further by the Expert Panel's review into the development of a seamless, national approach to energy access.
6.1	***The Gas Access Regime coverage criteria should provide the same threshold for coverage as declaration under the national access regime, such that a pipeline not satisfying the coverage criteria of the Gas Access Regime also will not satisfy the declaration criteria of the national access regime.***	• MCE accepts this recommendation.
6.2	***The first criterion for assessing coverage (s.1.9[a] of the Gas Code) should be amended to reflect the Australian Government's proposed change to s.44G(2)(a) in part IIIA of the Trade Practices Act (the national access regime). That is, that the National Competition Council would need to be satisfied:*** ***(a) that access (or increased access) to Services provided by means of the Pipeline would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the Services provided by means of the Pipeline.*** ***The Minister would also be bound by this change as per s.1.15 of the Gas Code.***	• MCE accepts this recommendation.

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6.3	***The Gas Access Regime should be modified such that the Minister and National Competition Council, in making a decision and recommendation, respectively, to cover a pipeline, should also decide and recommend, respectively, the form of regulation to apply.***	• The MCE accepts that a light handed monitoring option should be available in addition to up-front periodic assessments of reference tariffs. Consistent with the MCE's governance and institutional arrangements for the energy market, the decision about the form of regulation would be made by the AER, and reflect an assessment of the relative costs and benefits of applying the alternate regulatory options to a particular pipeline. The AEMC will be requested to develop clear criteria about the form and conduct of the cost-benefit assessment, taking into account the PC recommendations on this matter (see recommendations 6.4 and 6.5 below).
6.4	***The decision and recommendation on the form of regulation to apply should be based on an assessment of the net benefits to the economy of each form of regulation (an access arrangement with reference tariffs or monitoring option).*** ***Access arrangements with reference tariffs should be applied only where the net benefits of its application are markedly greater than the net benefits of the monitoring option. Otherwise the monitoring option should be applied.***	• See the response to recommendation 6.3.
6.5	***The Gas Access Regime should be amended to give guidance on matters that the Minister and the National Competition Council should consider in deciding and recommending, respectively, which form of regulation should apply to a covered pipeline.*** ***In determining the potential benefits of either form of regulation, the following matters should be taken into account:*** ***(a) the nature of demand for the commodities and services of end users of gas*** ***(b) the actual and potential level of competition from substitutes such as gas from other sources delivered through other pipelines, and other forms of energy*** ***such as electricity*** ***(c) the nature and extent of any barriers to entry in the market***	• See the response to recommendation 6.3.

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	(d) the degree of countervailing power in the market (e) the degree of horizontal and vertical integration (f) any other significant factors, subject to them being consistent with the proposed new objects clause. In determining the potential costs of either form of regulation, the following matters should be taken into account: (a) direct costs of service providers, governments and users (b) other costs (for example, distortions in behaviour arising from timeliness, regulatory risk and regulatory error (such as the inherent difficulties in determining efficient costs for services)) (c) any other significant factors, subject to them being consistent with the proposed new objects clause.	
6.6	***The Gas Access Regime should be amended to provide that where a service provider potentially covered by the Gas Code lodges a Part IIIA undertaking, this should trigger an assessment (currently by the National Competition Council) and decision (by the Minister) on whether the pipeline meets the requirements for coverage under the Gas Code. The Australian Competition and Consumer Commission's assessment of the Part IIIA undertaking should be held over, pending the outcome of the triggered coverage assessment and decision.***	• MCE accepts this recommendation. • MCE notes that the Australian Government has introduced legislation to amend the *Trade Practices Act 1974* to remove the possibility of 'forum shopping' between the National Access Regime and Gas Access Regime.
7.1	***In order to provide more specific and operational guidance for setting reference tariffs under the Gas Access Regime, and ensure consistency with the national access regime, s.8.1 of the Gas Code should be replaced with the following: s.8.1 A reference tariff or reference tariff policy should be designed with regard to the overarching objects clause, s.2.24 and the following principles: (a) that reference tariffs should: (i) be set so as to generate expected revenue for a reference service or services that is at least sufficient to meet the efficient costs of providing access to the reference service or services (ii) include a return on investment commensurate with the regulatory and commercial risks involved (b) that reference tariff structures should: (i) allow multi-part pricing and price discrimination when it aids efficiency (ii) not allow a vertically integrated service provider to set terms and conditions that discriminate in favour of its associated businesses in upstream or downstream markets, except***	• This matter will be considered further by the Expert Panel's review into the development of a seamless, national approach to energy access.

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	to the extent that the cost of providing access to non-associates is higher (c) that reference tariffs should be set so as to provide incentives to reduce costs or otherwise improve productivity.	
7.2	***To ensure there is no conflict with the pricing principles specified in recommendation 7.1, the following should be deleted from the Gas Code: the overview in italics at the beginning of s.8 ss8.2(c), 8.3(a), 8.38–8.43 and 8.45.***	• This matter will be considered further by the Expert Panel's review into the development of a seamless, national approach to energy access.
7.3	***To ensure there is no conflict with the pricing principles specified in recommendation 7.1, the first paragraph of s.8.44 of the Gas Code should be changed to: s.8.44 The Reference Tariff Policy should, wherever the Relevant Regulator considers appropriate, contain a mechanism (an Incentive Mechanism) that permits the Service Provider to retain all, or any share of, any returns to the Service Provider from the sale of Reference Services in aggregate (not individual Reference Services when there is more than one): And s.8.46 of the Gas Code should be changed to: s.8.46 The design of an Incentive Mechanism should be consistent with achieving the overall objective of the Gas Access Regime and the pricing principles specified in s.8.1.***	• See response to Recommendation 7.1.
7.4	***To ensure the guidance given to regulators is consistent with recommendation 7.1, s.8.6 of the Gas Code should be changed to the following: s.8.6 In view of the manner in which the Rate of Return, Capital Base, Depreciation Schedule and Non Capital Costs may be determined (in each case involving various discretions), a range of values may be attributed to the Total Revenue described in section 8.4. In order to assess whether a value proposed by a Service Provider is within this range the Relevant Regulator may have regard to any financial and operational performance indicators it considers relevant in order to determine whether the level of costs nominated by the Service Provider is within the range of plausible outcomes under section 8.4 that is consistent with the pricing principles contained in section 8.1.***	• See response to Recommendation 7.1.
7.5	***To provide greater flexibility for price regulation than that provided by the current building block approach, s.8.5 of the Gas Code should be replaced with the following: s.8.5 A Service Provider can use another method to calculate Total Revenue, provided the Relevant Regulator is satisfied that the proposed method is more likely to meet the overall***	• See response to Recommendation 7.1.

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	objective of the Gas Access Regime.	
7.6	***Section 8.21 of the Gas Code should be amended so that regulators can, at their discretion, undertake less public consultation than is required for a proposed revision to an access arrangement under s.2.28. If this discretion is exercised, the regulator should issue a written statement outlining clearly why the reduced public consultation was justified prior to issuing a binding decision under s.8.21 that proposed investment in an extension or expansion of a covered pipeline would meet the requirements for incorporation into the capital base.***	• See response to Recommendation 7.1.
7.7	***To ensure there is no conflict with the pricing principles specified in recommendation 7.1, s.8.26(c) of the Gas Code should be deleted.***	• See response to Recommendation 7.1.
7.8	***To ensure there is no conflict between the depreciation provisions of the Gas Code and the pricing principles specified in recommendation 7.1, ss8.32, 8.33(a) and 8.34(d) should be replaced with the following:*** ***s.8.32 The Depreciation Schedule is the set of depreciation schedules (one of which may correspond to each asset or group of assets that form part of the Covered Pipeline) that is the basis upon which the assets that form part of the Capital Base are to be depreciated for the purposes of satisfying the pricing principles in section 8.1.*** ***s.8.33(a) so as to result in the expected Total Revenue attributable to a Service Provider's Reference Services in aggregate (not individual Reference Services when there is more than one) changing over time in a manner that is consistent with the efficient operation and use of the Services (and which may involve a substantial portion of the depreciation taking place in future periods, particularly where the calculation of Total Revenue has assumed significant market growth and the Pipeline has been sized accordingly);*** ***s.8.34(d) the expected Total Revenue attributable to a Service Provider's Reference Services in aggregate (not individual Reference Services when there is more than one) should change over the Access Arrangement Period in a manner that is consistent with the efficient operation and use of the Services (and which may involve a substantial portion of the depreciation taking place towards the end of the Access Arrangement Period, particularly where the calculation of Total Revenue has assumed significant market growth and the Pipeline has been sized accordingly).***	• See response to Recommendation 7.1.
7.9	***To ensure regulators are given clear guidance about the uncertainty associated with calculating an ex ante regulatory rate of return, s.8.31 of the Gas Code should be changed to***	• See response to Recommendation 7.1.

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	the following: ***s.8.31 If a Rate of Return is used in determining a Reference Tariff then the method used to calculate the Rate of Return and the values used in applying that method shall in the first instance be proposed by the Service Provider. In assessing the Service Provider's proposal the Relevant Regulator must take account of the fact that there is no single correct method to determine a Rate of Return and there is often a range of plausible estimates that could be used in applying a Rate of Return method.*** ***The role of the Relevant Regulator is therefore to assess whether the Service Provider's:*** ***(a) proposed method has a plausible conceptual basis; and*** ***(b) values used in applying the method lie within the range of plausible estimates.*** ***The Relevant Regulator must approve the proposed method if (a) is satisfied. The Relevant Regulator must approve the values used in applying a method if (b) is satisfied.***	
7.10	***To ensure that the Gas Code is consistent with recommendations 7.1 and 7.5, s.8.30 of the Gas Code should be changed to the following:*** ***s.8.30 If a Rate of Return is used in determining a Reference Tariff then the Rate of Return should provide a return which is commensurate with prevailing conditions in the market for funds and the risk involved in delivering the Reference Service (as reflected in the terms and conditions on which the Reference Service is offered and any other risk associated with delivering the Reference Service including that resulting from regulation).***	• See response to Recommendation 7.1.
7.11	***A study should be undertaken by a group of recognised experts in the field of financial economics that considers whether a robust method can be developed for setting businesses' expected rate of return on capital under incentive regulation.*** ***This should include a review of the use of the capital asset pricing model by Australian regulators.***	• See response to Recommendation 7.1.
7.12	***To enable regulators to assess the cost allocations used to determine a service provider's total revenue, a new clause should be inserted in s.7 of the Gas Code as follows:*** ***During the Access Arrangement Period the Service Provider should collect and maintain data on the variables used as the basis of cost allocations for the purpose of deriving Total Revenue.***	• See response to Recommendation 7.1.
7.13	***The Gas Code should be amended so that the information that service providers are required to provide under ss2.6–2.7 and attachment A does not include information on cost allocations***	• See response to Recommendation 7.1.

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	between different reference services (where there is more than one) or between users.	
7.14	***To ensure that regulators cannot use State-based powers to access information beyond that specified in the Gas Access Regime, a new clause should be inserted into s.7 of the Gas Code as follows:*** ***The Relevant Regulator for the purposes of approving a Service Provider's Access Arrangement can only use information collected under the information collection powers specified in the Gas Access Regime.***	• MCE accepts this recommendation to the extent to which it will apply to the Western Australian regulator. The introduction of a national regulator (the AER) will largely solve the problem of multiple collection powers for all jurisdictions other than Western Australia.
7.15	***Section 3.16 of the Gas Code should be amended so that it unambiguously clarifies that any expansion of a covered pipeline will also be covered.***	• See response to Recommendation 7.1.
8.1	***The Gas Access Regime should be amended to provide for a light-handed form of regulation as an alternative to regulation involving an access arrangement with reference tariffs. The light-handed alternative should be a monitoring regime. It is important that the monitoring regime not develop into an intrusive and costly form of regulation.***	• As with the response to recommendation 6.3, the MCE accepts that a light handed monitoring option should be available in addition to up-front periodic assessments of reference tariffs. Consistent with the MCE's governance and institutional arrangements for the energy market, the decision about the form of regulation would be made by the AER, and reflect an assessment of the relative costs and benefits of applying the alternate regulatory options to a particular pipeline. The AEMC will be requested to develop clear criteria about the form and conduct of the cost-benefit assessment, taking into account the PC recommendations on this matter (see recommendations 6.4 and 6.5 above).
8.2	***The proposed monitoring form of regulation to be incorporated into the Gas Access Regime should have the following features:*** ***a third party access policy formulated by the service provider which would have some minimum requirements relating to processes for negotiating access and binding arbitration in the event of a dispute over access*** ***subjecting service providers to provisions for anticompetitive conduct (the current s.13 of schedule 1 of the Gas Pipelines Access Law)*** ***minimum ring fencing provisions*** ***public disclosure of specified information by the service provider for monitoring purposes only (which would be well short of the 'access arrangement information' currently required under the Gas Code)***	• The MCE will implement a variant on this recommendation, namely: • the use of the dispute resolution procedures in the Gas Code for disputes over access (rather than a process proposed by the service provider); • retaining the other regulatory measures (including ring fencing) as recommended by the PC; and • information disclosure requirements that reflect the circumstances of individual pipelines.

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	scope for the service provider to adopt, at its discretion, additional features, such as a voluntary code of conduct.	
8.3	***The access policy prescribed by service providers under the proposed monitoring regime should include at a minimum:*** ***processes for negotiating access*** ***dispute resolution procedures (including provision for binding commercial arbitration).***	• This is unnecessary as the MCE model will make use of the Gas Code dispute resolution procedures.
8.4	***Under the proposed monitoring regime, to encourage service providers to provide third party access, service providers and related parties should be subject to the anticompetitive conduct provisions of the Gas Pipelines Access Law dealing with preventing or hindering access (s.13 of schedule 1 of the Gas Pipelines Access Law).***	• MCE accepts this recommendation.
8.5	***Under the proposed monitoring regime, a service provider should comply with the minimum ring fencing requirements in s.4.1 of the Gas Code. However, s.4.1(e) should not apply for monitored pipelines, rather a new alternative provision should apply as follows: allocate any costs that are shared between an activity that is covered by a set of accounts described in s.4.1(c) and any other activity according to a methodology for allocating costs that is transparent and disclosed as part of the monitoring regime information disclosure requirements.***	• MCE accepts this recommendation.
8.6	***Under the proposed monitoring regime, information disclosure requirements should involve:*** ***focusing more on trend performance, including profitability*** ***reporting and monitoring after the event, without any need for prior endorsement by the regulator*** ***the regulator particularly recording cases where access negotiations have been unsuccessful.***	• MCE accepts this recommendation. Rules for the operation of the monitoring function will be developed.
8.7	***To improve regulatory certainty, and reduce the possibility of regulatory creep, information disclosure requirements of the proposed monitoring regime should be set out in disclosure guidelines developed prior to implementation of the monitoring regime. The National Competition Council, or another suitable organisation other than the regulator undertaking the monitoring function, should be responsible for developing this generic set of guidelines. This should involve an open and transparent consultative process. It should be the responsibility of the entity developing the guidelines (the National Competition Council, for***	• MCE accepts this recommendation in part. The AEMC will be the appropriate entity to develop such rules.

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	example) to update the guidelines when substantive need arises.	
8.8	***The relevant regulator should collate and publish annually the information disclosed by a service provider under the proposed monitoring regime. Any commentary made by the regulator should be of a factual nature only, for example, the regulator should not make any determinations on the appropriateness of costs and prices.***	• MCE does not accept this recommendation. Rules for the operation of the monitoring function will be developed.
8.9	***To ensure the data disclosed by service providers under the proposed monitoring regime are accurate:*** ***chief executive officers (CEOs) should be required to sign a declaration stating that the data are true*** ***financial information and financial performance measures should be certified by an auditor*** ***financial penalties should be available through the courts if companies refuse to provide the required monitoring data within the established deadlines.***	• MCE does not accept this recommendation. Rules for the operation of the monitoring function will be developed.
8.10	***Where the proposed monitoring option is applied, it should apply for a minimum period of five years, during which there would be no shift to access arrangement with reference tariffs regulation. Following this period, monitoring would continue to apply, subject to a decision by the Minister, following a recommendation by the National Competition Council, and an application from the monitoring regulator that access arrangement with reference tariffs regulation should apply. A decision to continue with monitoring would apply for a five-year period. Any person can apply for revocation of coverage of a monitored pipeline at any time.***	• MCE does not accept this recommendation. The AER will determine whether the requirement to submit access arrangement revisions should be waived. Rules for the operation of the monitoring function will be developed.
8.11	***For pipelines that are covered and subject to the proposed monitoring regime, only the relevant regulator should be able to apply to the National Competition Council to shift the form of regulation to access arrangements with reference tariffs.***	• MCE does not accept this recommendation. Rules for the operation of the monitoring function will be developed.
8.12	***Pipelines currently covered with cost-based price regulation should remain covered, and continue to be subject to the access arrangement with reference tariffs regulation. Movement from this price regulation would require an application to the National Competition Council for revocation. Following a recommendation from the National Competition Council, the Minister would make a decision on coverage, and the form of regulation where coverage is retained.***	• MCE accepts the recommendation in part. The AER will decide whether the requirement to submit access arrangement revisions will be waived.
8.13	***To remove uncertainty, pending a decision by the Minister following a recommendation from***	• This issue is being addressed in the context of the response to

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	the National Competition Council that the Gas Access Regime would be certified as effective, clause 6 of the Competition Principles Agreement should be modified as supported by the Australian Government in its response to the recommendation in the Commission's review of the national access regime.	the PC review of the national access regime.
9.1	***The Gas Access Regime should be amended so that the relevant Minister, after receiving a recommendation from the National Competition Council, can provide a binding no-coverage ruling for a proposed pipeline if it does not meet the coverage criteria. A binding no coverage ruling should remain in effect for 15 years from when the pipeline commences operations, unless the information relied on by the relevant Minister or National Competition Council was intentionally misleading. After 15 years of operation, a pipeline that was subject to a binding no-coverage ruling should continue to remain uncovered unless there is a successful coverage application.***	• MCE accepts this recommendation. MCE will also introduce price regulation holidays for greenfield pipelines.
9.2	***If recommendation 9.1 is implemented, then the national access regime (Part IIIA of the Trade Practices Act 1974) should be amended so that a gas pipeline cannot be declared while it is subject to a binding no-coverage ruling under the Gas Access Regime.***	• This matter is being addressed separately by the Commonwealth.
10.1	***Section 7.1 of the Gas Code should be amended so that a service provider entering an associate contract for the supply of a reference service at the reference tariff is not required to seek authorisation. However, the service provider must provide the contract and any necessary information to the relevant regulator to satisfy the regulator that it is a contract for a reference service at the reference tariff.***	• The MCE accepts this recommendation in part. The service provider will be required to report all associate contracts to the AER. The AER will be empowered to have associate contracts that undermine the integrity of the ring fencing provisions voided.
10.2	***The associate contract provisions should be amended to clarify that these provisions do not apply to asset management contracts.***	• The MCE does not accept this recommendation. Determining what is and what is not an asset management contract is not simple. Further the imposition of the reporting requirement obviates the need for this exemption.
10.3	***To ensure regulators can adequately assess the costs of an associated business that undertakes activities under service agreements and contractual arrangements with a service provider in relation to a covered pipeline, the following subsections should be added to s.4.1 of the Gas Code:*** ***s.4.1B An Associate of a Service Provider of a Covered Pipeline that undertakes activities under service agreements and contractual arrangements with a Service Provider in relation to***	• The MCE accepts this recommendation in concept. The actual drafting of the provisions will be determined as part of the drafting of the National Gas Rules.

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	the Covered Pipeline must (if requested by the Relevant Regulator): ***(a) establish and maintain a separate set of accounts in respect of the Services provided to the Covered Pipeline*** ***(b) allocate any costs that are shared between an activity that is covered by a set of accounts described in s.4.1B(a) and any other activity according to a methodology for allocating costs that is transparent.*** ***s.4.1C A Service Provider when entering service agreements and contractual arrangements with an Associate for activities undertaken in relation to a covered pipeline, must ensure that the terms and conditions of the contract will allow s.4.1B to be implemented.***	
10.4	***To ensure regulators can adequately assess the costs of an associated business that undertakes activities under service agreements and contractual arrangements with a service provider in relation to the covered pipeline, the following subsection should be added to s.4.2 of the Gas Code:*** ***s.4.2A In complying with ss4.1B(a) and (b) an Associate of a Service Provider must:*** ***(a) if the Relevant Regulator has published general accounting guidelines for Associates which apply to the accounts being prepared, comply with those guidelines; or*** ***(b) if the Relevant Regulator has not published such guidelines, comply with guidelines prepared by the Associate and approved by the Relevant Regulator or, if there are no such guidelines, comply with such guidelines (if any) as the Relevant Regulator advises the Associate apply to that Associate from time to time.*** ***Such guidelines may, amongst other things, require the accounts to contain sufficient information, and to be presented in such a manner, as would enable the assessment (and benchmarking) by the Relevant Regulator of the costs of the activities undertaken in relation to the Covered Pipeline by an Associate under service agreements and contractual arrangements with a Service Provider.***	• The MCE accepts this recommendation in concept. The actual drafting of the provisions will be determined as part of the drafting of the National Gas Rules.
10.5	***To remove potentially conflicting objectives from the Gas Access Regime, s.4.1(e) of the Gas Code should be amended to delete reference to the term 'otherwise fair and reasonable'.***	• See response to Recommendation 7.1.
11.1	***The Gas Access Regime should be amended, whereby the regulator would be able to extend the period for approval of an access arrangement by two months only once. If judicial proceedings commence, the regulator's time should automatically be extended by the length of time taken to complete the judicial proceedings.***	• The MCE accepts the concept behind recommendations 11.1 – 11.3. The timing issues of regulatory decision making will be progressed in the drafting of the new legislative framework.

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11.2	***The Gas Access Regime should be amended whereby the 'further final decision' should be removed from the approval process for access arrangements.***	• See response to Recommendation 11.1.
11.3	***The Gas Access Regime should be amended so regulators can specify a date by which the service provider must submit proposed amendments to an access arrangement.***	• See response to Recommendation 11.1.
11.4	***Limitations on the grounds of appeal under s.39 of the Gas Pipelines Access Law should be removed to allow a full merits review on access arrangements drafted and approved by the regulator. This would be consistent with the grounds of merits review for coverage decisions.***	• A MCE SCO consultation paper has been released to canvass views on the issue of merit review principles and the decisions under the NEL and NGL which may be appropriate for merits review.
11.5	***The material that can be introduced to the appeal body for a merits review of a coverage decision under s.38 of the Gas Pipelines Access Law should be restricted to material that has already gone before the primary decision maker. This would be consistent with the merits review process for access arrangements drafted and approved by the regulator.***	• See response to Recommendation 11.4.
12.1	***The agency that recommends coverage of a pipeline, should also be responsible for recommending the form of regulation to apply to the pipeline.***	• MCE does not accept this recommendation. The AER will decide whether the requirement for a service provider to submit access arrangement revisions will be waived.
12.2	***The agency responsible for making recommendations on pipeline coverage and form of regulation decisions (currently the National Competition Council) should be separate from the regulator actually responsible for administering the regulation (either monitoring or access arrangements with a reference tariff).***	• The first part of the recommendation is accepted – the agency who will advise on coverage (AEMC) will be separate from the agency administering that regulation. Regarding the form of regulation, see response to Recommendation 12.1.

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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] Alone, COAG's decision to replace the numerous state, territory and national regulators with a single regulator will not create a consistent and seamless approach to regulation across the energy sector. Rather, to the extent practicable, and where effective regulation is not impeded, a common set of legal provisions (that is, the law and statutory rules as described

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[7] AEMA, clauses 2.1(b)(i)-(ii).

[8] AEMA, clause 1.4 and annexure 1.

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above) to guide the regulator across electricity and gas transmission and distribution across jurisdictions is desirable.

The Productivity Commission recently undertook a review of the Gas Access Regime and made a series of recommendations to the detailed guidance that is provided to regulators, the procedures required to be followed, and on high level policy matters (such as regulators information gathering powers). A number of other the energy market reforms that already have been undertaken or are currently proceeding are directly relevant to access regulation in the energy sector. The new National Electricity Law puts in place (amongst other things), the legal framework for 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. In addition, the MCE has commenced work on examining the issues associated with extending a national framework for energy access to electricity and gas distribution and retail (other than retail pricing), including the release of an Issues Paper in August 2004.

A key objective for the realisation of COAG's vision for reform is to bring together the currently disparate 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 model legislative provisions for a seamless, national approach to access as well as the model contents for the subsidiary statutory rules.

A key issue for the MCE is to keep to a minimum the costs that are created, where the decision has been made to impose price regulation. Accordingly, the panel is requested to consider and report on the potential for alternatives to the current 'building block' approach to reduce the cost of price regulation, while maintaining effectiveness. One approach to be considered is to use the trend in 'total factor productivity' to inform the expected trend in prices;[9] the panel would need to consider the full regime that would accompany examination of such trends.

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

- the scope for 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; and

- the high level regulatory policy issues that have been raised in recent access reviews (including but not limited to the Productivity Commission's review of the Gas Access regime), including:

    - the appropriate scope of the AER's information gathering powers;

    - the scope for using total factor productivity (TFP) indexing as a basis for updating price controls following the establishment (or re-establishment) of initial prices under building

[9] Farrier Swier Consulting 2002, Comparison of Building Blocks and Index-Based Approaches, Report for the Utility Regulators Forum.

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blocks methodologies and the desirability of undertaking TFP measurement across all jurisdictions; and

- the scope of a regulator's decision making powers (including the relative merits of creating a legal bias in favour of the regulator accepting the proposal from a regulated entity).

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 recommendations and findings of the Parer Review;
- The Gas Pipelines Access Law and the current Gas Code;
- The National Electricity Law and the current National Electricity Rules;
- The work undertaken by the MCE on extending a national framework for energy access to electricity and gas distribution and retail (other than retail pricing);
- The AEMC's current review of the rules for the economic regulation of electricity transmission; and
- The Victorian Essential Services Commission's research into the measurement of TFP for electricity distribution, the analysis and quantification of the incentive power of alternative regulatory regimes and the implementation issues associated with indexing.

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 agree 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.

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