

Regulatory Impact Statement

Gas Access Regime – The Coverage Test

This RIS is for consultation only and should not be read as a settled or final view of the Standing Committee of Officials or the Ministerial Council on Energy.

BACKGROUND

In 2003-04, the gas industry contributed 0.2 per cent of Australia's GDP of more than \$788 billion.

Australia's natural gas consumption grew from 733 Petajoules (PJ) in 1993-94 to 951 PJ in 2001-02. ABARE has forecast that natural gas consumption will grow at about 3.7 per cent per annum to 1828 PJ in 2019-20. Over the same period natural gas is projected to increase its share of Australia's primary energy consumption from 18.7 per cent to 24.2 per cent.

Significant investment in gas infrastructure, including pipelines, will be required to meet this level of future demand. The Productivity Commission (PC) found that while there has been impressive growth in the gas sector, the design and application of the gas regulatory regime has the potential to deter investment in the future. The PC has recommended a number of changes to the gas regulatory regime to improve the certainty for investors in pipelines and minimise the costs of regulation, while protecting customers from the misuse of market power.

PROBLEM

The National Access Regime (Part IIIA of the *Trade Practices Act 1974*) is the overarching regime that provides for third party access to essential infrastructure. The threshold for coverage (regulation) is currently higher for the National Access Regime than it is for the Gas Access Regime. This is not in line with the Government's policy objective to promote consistency between regulatory regimes where possible.

The PC's assessment found that, on balance, the Gas Access Regime is likely to be distorting investment in favour of less risky projects, including altering the nature and timing of pipeline investments. It is therefore likely that the current regulatory regime is generating an inefficient and sub-optimal investment environment.

The PC stated that the likely distortion to investment is due to the combination of the current coverage test and the potential for regulatory error, regulatory risk and asymmetric truncation. Therefore, these factors should be considered when considering regulatory reform.

The PC evaluated the coverage test as part of its overall assessment of the gas access regime. While the PC did not explicitly provide persuasive arguments for or against the proposition that the current coverage threshold is reducing investment, on balance it considered that the coverage test for the Gas Access Regime sets too low a threshold for regulation and recommended that the coverage threshold be raised.

OBJECTIVE

The objective of government action is to ensure that regulation is only applied in circumstances where the benefits of it clearly outweigh the costs, thereby achieving an improvement in economic efficiency within the gas market for the benefit of the community as a whole.

OPTIONS

Option 1 – Status Quo

Continue to apply the coverage test for the Gas Access Regime in its current form.

Option 2 - Align the coverage test for gas transmission and distribution pipelines with the coverage test in Part IIIA of the *Trade Practices Act 1974*.

This option would involve inserting the word ‘*material*’ in coverage criterion (a) so that only those pipelines for which coverage would generate a *material* increase in competition in a related markets would be regulated.

This rewording would raise the threshold for coverage under the Gas Access Regime and bring it into line with the declaration criteria under the National Access Regime.

In its draft report the PC proposed to raise the hurdle for coverage criterion (a) such that access would be likely to have the effect of increasing competition to a *material* degree. This wording reflected advice from the Australian Government Solicitor who considered this threshold was higher than the current requirement to ‘promote competition’ (p.210). It is not possible to assess how the National Competition Council (NCC) will interpret and apply the amended criterion in practice, but it is likely that the amendment will have the effect of raising the threshold.

IMPACT ANALYSIS

Major stakeholders that are likely to be affected by the following options include: pipeline owners, upstream gas producers, major gas users, final consumers, regulators and the Government.

Option 1 - Status Quo

Benefits

- A continuation of the current coverage criteria of the Gas Access Regime would result in no transitional costs being incurred by the various parties.

Costs

- The Government has already agreed to raise the declaration threshold for the National Access Regime. Therefore, if the current coverage criteria were retained the Gas Access Regime would be inconsistent with the National Access Regime.
- The Productivity Commission considered that the coverage test for the Gas Access Regime sets too low a threshold for regulation.
- As a result some gas pipelines may be being regulated where the benefits of coverage do **not** clearly outweigh the costs.

Option 2 - Align the coverage test for gas transmission and distribution pipelines with the coverage test in Part IIIA of the *Trade Practices Act 1974*.

Benefits

- The Productivity Commission proposed raising the threshold to ensure coverage is likely to result in a significant improvement to economic efficiency (p.210).
- It is more likely that only pipelines with substantial market power will meet the test for coverage, thus lessening the chances that formal price control is imposed where the benefits of regulation do not exceed the costs.
- It is likely that raising the regulatory threshold and reducing the scope for regulatory error will encourage greater investment, interconnection and competition to take place between gas pipelines, thereby facilitating improved reliability of supply and lower long term prices for the benefit of consumers and the wider community.
- Since the Gas Access Regime is a subset of the National Access Regime, aligning the coverage threshold of the two regimes will ensure that the overarching objective of the National Access Regime is protected and maintained.
- The PC recommended that in light of the Australian Government's proposed change to the declaration criteria for the National Access Regime, the coverage criterion (a) of the Gas Access Regime should be similarly changed (p.225).

- Pipelines on the margin of coverage under the existing criteria may be able to have their coverage revoked.
- Similarly, since it is likely that fewer pipelines will be subject to coverage, fewer access arrangements may also need to be implemented. This should result in the following savings:
 - i) Reduced administrative costs for industry and the regulator associated with establishing access arrangements.
 - ii) Reduced ongoing compliance costs associated with providing information to the regulator during the regulatory period.

This will predominantly benefit pipeline owners, the NCC and taxpayers in terms of a reduction in administrative and compliance costs.

Costs

- Short term transitional costs may be incurred by the NCC in the process of determining the appropriate interpretation and application of the amended coverage criteria.
- A case history has developed under the current Gas Access Regime, which has provided a degree of certainty about the interpretation and application of current coverage criteria. Therefore, amending the coverage criteria may result in a period of short term uncertainty while a new case history develops.
- Additional costs may be incurred by pipeline owners and the NCC in the short term as marginal pipelines currently subject to coverage apply for revocation.
- Price increases for some end users may result in the short term. However end users are likely to benefit from lower prices in the longer term as is outlined in the benefits section. Any potential price increase will be limited by the fact that the regulatory regime will still apply where competition can be *materially* increased.
- Where pipelines are revoked from coverage, upstream producers and users may incur additional costs in negotiating contracts with service providers.

Impact of Option 2 on the major stakeholders

	Benefits	Costs
Upstream gas producers	<ul style="list-style-type: none"> Increased pipeline investment, interconnection and penetration of gas are likely to enable producers to supply more markets in the longer term. 	<ul style="list-style-type: none"> Potentially a transitional period of uncertainty as the NCC determines the interpretation of the amended criterion. Where pipelines are revoked from coverage additional costs of negotiating contracts may be incurred.
Pipeline owners	<ul style="list-style-type: none"> Less likely that formal price control will be imposed on pipelines where the benefits of regulation do not exceed the costs. Greater investment is likely as the scope for regulatory error decreases. Pipelines on the margin of coverage under the existing criteria may be able to have their coverage revoked. Pipelines on the margin of coverage under the existing criteria could then be spared the administrative and compliance costs associated with coverage assessments and establishing access arrangements. 	<ul style="list-style-type: none"> Potentially a transitional period of uncertainty as the NCC determines the interpretation of the amended criterion. Pipelines on the margin of coverage under the existing criteria that apply for revocation of coverage may incur costs associated with the process.
Gas users	<ul style="list-style-type: none"> Greater interconnection and penetration of gas is likely. Increased competition in the longer term is likely to lead to lower prices. 	<ul style="list-style-type: none"> Potential transitional period of uncertainty as the NCC determines the interpretation of the amended criterion. Where pipelines are revoked from coverage additional costs of negotiating contracts may be incurred.
Final consumers	<ul style="list-style-type: none"> Greater interconnection and penetration of gas is likely. Increased competition in the longer terms is likely to lead to lower prices. 	<ul style="list-style-type: none"> Some consumers may experience price increases in the shorter term.
Government	<ul style="list-style-type: none"> The Gas Access Regime will remain consistent with the National Access Regime. Likely to encourage a greater penetration of gas. 	
Regulator	<ul style="list-style-type: none"> Reduced administrative costs associated with establishing access arrangements. 	<ul style="list-style-type: none"> The NCC may incur short term costs as it determines the appropriate interpretation of the amended criterion. The NCC may incur transitional costs if marginal pipelines decide to apply for revocation of coverage.

CONSULTATION

- The Treasurer asked the Productivity Commission (PC) to examine current gas access arrangements on 13 June 2003. The Inquiry involved wide industry consultation with a variety of groups within, and related to, the gas industry, including pipeline owners and operators, gas users, industry associations, regulators and other government agencies. A total of 76 submissions were received in response to the issues paper that the PC released in July 2003. The Commission also held two rounds of public hearings in Perth, Adelaide, Melbourne, Brisbane and Sydney.
- The Draft Report was released for public comment on 15 December 2003. A total of 50 submissions were received in response to the draft report and a number of modifications were subsequently incorporated into the final report. The final report was presented to Government in June 2004.
- A Consultation Paper outlining options under consideration for MCE's response to the PC Review in relation to the key issues was released on 15 August 2005. A further 22 submissions were received.

IMPLEMENTATION AND REVIEW

The Ministerial Council on Energy (MCE) decision would be incorporated into the National Gas Law (NGL), which is currently being developed as part of the gas legislative package. The MCE aims to release an exposure draft of this package by the end of February 2006 for stakeholder consultation.

It is expected that the new NGL will be introduced into the South Australian and Western Australian Parliaments in mid 2006. Application Acts will also be introduced into other jurisdictions' Parliaments.

Under the new gas legislative package it is proposed to give the Australian Energy Market Commission (AEMC) the same powers to conduct reviews in relation to gas on the direction of the MCE as it currently has in relation to electricity. The MCE would then be able to direct the AEMC to conduct a review which may include assessing the effectiveness of the change to the coverage criteria and the National Gas Law more broadly. The AEMC would report its findings and recommendations to the MCE, which would decide whether changes to the coverage criteria or the broader National Gas Law would be appropriate.

CONCLUSION

Maintaining the status quo and continuing to apply the coverage test for the Gas Access Regime in its current form would not be consistent with ensuring that only those pipelines which need to be regulated to achieve economic efficiency are regulated. This option would fail to improve certainty and efficiency in the gas market.

Option 2, being to align the coverage test for gas transmission and distribution pipelines with the coverage test in Part IIIA of the *Trade Practices Act 1974*, will ensure the Gas Access Regime is consistent with the National Access Regime and is likely to facilitate an improvement in economic efficiency within the gas market. Although pipeline owners, regulators, upstream producers and end users may incur some transitional and short term costs, a net benefit is likely to be derived for all parties including the wider community as a result of increased pipeline investment. For example, it is likely that reducing the scope for regulatory error will encourage greater investment, interconnection and competition to take place between gas pipelines, thereby facilitating improved reliability of supply and lower long term prices for the benefit of the wider community.