



5 January 2006

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National Gas Legislative Package: Exposure Draft

The Energy Supply Association of Australia (esaa) appreciates the opportunity to comment on the draft national gas legislative package – the proposed National Gas Law (NGL) and National Gas Rules (NGR). esaa is the peak industry body for the stationary energy sector in Australia. It represents the policy positions of the Chief Executives of 44 electricity and downstream gas businesses in Australia. These businesses own and operate some \$110 billion in assets, employ over 40,000 people and contribute \$12.4 billion dollars to the nation's gross domestic product.

The Association's overarching aim is to secure market and policy conditions that support the competitive, efficient and reliable supply of electricity and natural gas. Consistent with this, esaa strongly contends that the regulation of the industry, where required, should be through a single national regime that is light-handed, low cost and that delivers high quality regulatory decisions. These decisions should be subject to merit and judicial review and, once concluded, be enduring given the long-lived nature of the assets involved.

The Exposure Draft of the gas legislative package is intended to provide a new legal framework for the existing provisions of the Gas Pipelines Access Law and National Gas Code along with policy changes in response to the Council of Australian Governments' (COAG) Energy Market Review, the PC Review of the Gas Access Regime and the findings of the Ministerial Council on Energy's (MCE) Expert Panel.

While the draft gas legislative package does attempt to incorporate all of these elements, we are concerned that in a number of areas the legislative package moves well beyond the agreed policy framework and would have far reaching consequences if retained in the final version. esaa, in conjunction with the Energy Networks Association, has commissioned detailed legal advice that supports this view. In particular, the significant gains that were made in relation to the governance of the electricity market have been compromised; the proposed information gathering powers are still more excessive than those included in the National Electricity Law (NEL); and the appropriateness of the previously agreed limited merits review model has been eroded.

Governance

In response to recommendations from the MCE, COAG signed the Australian Energy Market Agreement to “strengthen the quality, timeliness and national character of governance of the energy markets, to improve the climate of investment” and “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”.

To deliver these aims, COAG established the MCE as a high-level national policy and governance body for the Australian energy market. Importantly, COAG agreed that the MCE would “not be engaged directly in the day-to-day operation of the energy markets or the conduct of regulators.” To support this model, a statutorily independent rule-maker – the Australian Energy Market Commission (AEMC) – and regulator – the Australian Energy Regulator (AER) – were created, both with substantial technical expertise, to separate rule-making from regulation. This governance model was a cornerstone of the energy market reform program and had the general support of both industry and consumers.

However, the proposed national gas legislative package moves both the MCE and the legislative structure beyond setting the high-level policy framework and directly into the “day-to-day operation of the energy markets and conduct of regulators”. In addition, the principle of ensuring a clear separation between rule-making and regulation has been compromised.

The industry therefore urges the MCE to re-assert the importance of these governance arrangements and protect the independent role of both the rule-maker and the regulator. These bodies should be independent of both governments and industry and, more importantly, independent of each other. Staffed with relevant economic and regulatory rule-design expertise, the rule-maker should be left to independently determine the most appropriate detailed rules, consistent with the high level policy guidance provided in the law. If jurisdictions view these rules as inconsistent with the market objective - couched in terms of the ‘long-term interests of consumers’ - then the rule change process, also established within the law, will provide the appropriate mechanism for review. The MCE also has the opportunity to develop binding Statements of Policy Principles to guide AEMC rule-making if this is required. This process – rather than legislation or regulation – should be the mechanism through which any additional policy guidance is delivered to the AEMC to ensure it is done in an effective, clear and transparent manner.

Role of MCE and AEMC

The NEL was the first opportunity for governments to implement the new energy market governance arrangements. The MCE established the objects clause for the NEL and provided a set of broad principles to guide the regulator’s discretion in making network revenue or pricing determinations. In line with the established governance model, the detailed rules to underpin these determinations were left to the discretion of the independent and expert rule-maker (AEMC) with the assistance of a public and transparent consultative process. Although the industry had concerns

about the information gathering/enforcement powers contained within the NEL, esaa along with the ENA, ERAA and the NGF all observed that the “majority of the legislative package broadly reflect[ed] the policy announcements of the MCE”.

Unfortunately, the same cannot be said for the proposed National Gas Law and National Gas Rules.

The Standing Committee of Officials (SCO) in their *Statement of Approach on a New Legislative Framework for Gas* set out five key principles to ensure that the “provisions of the NGL provide certainty to regulatory processes, creating an environment conducive to ongoing investment” while “the flexibility of the rule change process allows the detail of regulation to be responsive to the needs of market participants”:

- wherever feasible, and unless there is a good policy reason to do otherwise, alignment with the new electricity regulatory regime should occur;
- the architecture of the regulatory framework should be enshrined in the NGL (i.e. high level policy and framework matters will be included in the NGL);
- procedural and technical details should remain in the new Gas Rules
- the rule change process should be enshrined in the NGL; and
- general legislative principles which confer and determine the scope of functions, powers, rights and obligations should be included in the NGL.

However, in a number of places the draft law moves beyond the high level policy framework and proposes to enshrine in legislation or through Regulations procedural and technical details that are rightly the preserve of the AEMC and the NGR.

For example, much of Chapter 4 of the proposed NGL deals with the process for, content of, effects of and decision-making criteria for access arrangements and access disputes made/heard by the AER. These are procedural and technical details that would be better dealt with under the NGR.

Of greater concern is the apparent use of the NGL to move the MCE beyond high-level policy direction and into the “day-to-day operation of the energy markets or the conduct of regulators”. The proposed NGL not only prescribes the decision-making framework for regulation (receive-determine model) but goes so far as to prevent the NGR from providing for a total factor productivity approach to economic regulation. Economic regulation is a particularly complex area and the agreed governance model recognised that the MCE/SCO was not well placed to determine how this should be conducted to lower the cost and complexity of regulation facing investors and enhance regulatory certainty. The AEMC, staffed with technical expertise and subject to a national market objective and policy guidance from the MCE, is much better placed to develop a best-practice regulatory framework within the NGR.

The PC Review of the Gas Access Regime and the Prime Minister’s Infrastructure Taskforce recommended regulators be required, in assessing terms and conditions, to accept the proposed access terms and conditions submitted by the service

provider if they fall within a “*reasonable range of values*”. However, the MCE’s Expert Panel considered that this form of the propose-respond model (and its legal interpretation) raised “difficult questions of principles and practicality”. In its recommendations, the Panel proposed that the Law not mandate the use of any particular decision-making framework, but have the Rules *draw on both the propose-respond and receive-determine approach*. Although the MCE indicated it would accept the views of the Expert Panel, the proposed NGL effectively removes the propose-respond model from the “available forms”. The Association’s legal advice states that:

“the Proposed Gas Law and the Proposed Initial Gas Rules in effect has not adopted the “fit-for-purpose” model for the Australian Energy Regulator’s (AER) core economic regulatory role of approving access arrangements and instead the “consider-determine” model is adopted.

That is, the Proposed Gas law would:

- *require the business to submit a proposed access arrangement; and*
- *whether or not the AER identifies any flaw in any aspect of the business’s proposal or inconsistency with the Law or Rules, empower the AER to reject it and to substitute its own access arrangement in accordance with certain pricing principles.*

Further, certain provisions of the Proposed Gas Law would institutionalise a statutory preference for that model to remain and, indeed, the Law would in certain respects prevent a rule change seeking to adopt the “fit-for-purpose” model.”

Instead of implementing the Expert Panel’s recommendation that “it is not appropriate for the Law to mandate a receive-determine model”, the proposed NGL effectively does exactly the opposite.

esaa considers that the proposed NGL should be re-drafted to clarify its role as setting the high-level policy framework and the initial NGR re-drafted to contain the procedural and technical details relating to economic regulation.

We would be happy to discuss with Ministers and/or officials how this could be achieved.

Roles And Powers of the AER and AEMC

Legal advice obtained by esaa also emphasises that the proposed NGL would significantly undermine the clear separation between rule-making and regulation/rule enforcement. In this area we have two key concerns:

- Firstly, the degree of discretion accorded to the AER is so extensive that it will *de facto* implicitly make rules as it makes decisions or explains its approach to making decisions. Thus, many of the finer details of the regulatory structure will be unclear until the AER makes a decision or issues a statement as to how it will exercise its discretion.

- Secondly, the rule-making power of the AEMC, which enables it to give the AER the power to make guidelines, has the potential to be misinterpreted as being sufficiently broad for the AER to make regulatory instruments which are indistinguishable from the rules.

The separation of roles which has previously been endorsed by the MCE has been confused and conflicted in the draft legislation. There is scope for the final legislation to be revised to reinstate this separation and appropriately apply powers to each body and to ensure the degree of discretion afforded to the AER is also appropriate.

Information Powers

The Productivity Commission recommended that the regulator's powers in relation to information disclosure should ensure that the regulatory burden does not outweigh the efficient operation of the service provider.

In determining the information disclosure requirements, the MCE has responded in favour of the views expressed by the Expert Panel which called for a strengthening of information disclosure provisions.

The MCE Standing Committee of Officials (SCO) notes that the regulatory regime, consistent with the view of the Expert Panel, is intended to:

- Enable the AER to obtain adequate information from industry to set efficient prices for energy services without placing an unnecessarily administrative heavy burden on industry; and
- Support competition in the energy market place, while protecting legitimate commercially privileged information.

According to a statement from officials at the recent industry stakeholder forum (23 November 2006), the application of the regulatory functions by the AER and AEMC should adhere to these two key principles.

However, we note that there is an apparent internal conflict between the intention to ensure information can be obtained from "all associate contracts" (with an expanded and uncertain definition of what constitutes an "associate contract") and the MCE commitment to "an effective enforcement regime with appropriate information gathering and sharing powers". In addition, in response to comments received on the Statement of Approach for the National Gas Legislative Package, the SCO indicated the legislative drafting would ensure consistency with other regulatory information gathering powers for Commonwealth regulators and would not be "intended to create a significant burden on industry".

esaa's legal advice confirms that the proposed information gathering provisions are more extensive than any other equivalent regulatory regime. This advice notes that the new powers for the AER on information gathering and information publication "*are likely to significantly abrogate businesses general rights to confidentiality and could impose considerable costs in complying with the requests*". The advice notes that although information powers given to both the AEMC and the AER are based upon similar powers in other contexts, they have been transposed in the proposed

NGL without “effective checks and balances on the use of the powers” alongside “a multiplicity of concurrent powers” which extends the reach of information gathering powers beyond the scope of comparable powers in other Australian utilities law or regulation to date.

Merits Review

The proposed NGL includes provisions relating to a limited form of merits review, previously proposed and implemented following a separate MCE process.

As noted in esaa’s response to the proposed options for regulatory review – and recognised by the SCO at the time – the design of an **appropriate** review regime is “dependent on the larger framework” that applies. As such, our support for the limited merits review model was articulated in the context of the existing regimes. However, esaa did suggest at the time that the MCE consider widening the scope of reviewable decisions.

The draft gas legislative framework significantly extends the discretion and reach of the regulator and, therefore, the agreed limited merits review model is no longer appropriate and warrants further consideration. As confirmed by our legal advice, the agreed limited merits review model is not appropriate where there is **not** a concomitant restriction on the regulator’s decision making powers and discretion.

In addition, the provisions that would enable the Regulations to further specify which regulatory decisions are subject to merits review is not appropriate. Our advice states that: “the Proposed Gas Law itself, not the Regulations, should identify regulatory decisions which are subject to merits review. The decisions are:

- decisions in relation to the coverage of gas pipelines;
- decisions on the form of regulation to apply (for example, whether to apply “light regulation”);
- decisions to approve or reject gas access arrangements; and
- ring fencing decisions including on approval or otherwise of associate contracts.

Where the Rules provide for additional decisions to be made it should also be possible for the Rules to provide for merits review.”

Conclusion

The draft legislative package moves well beyond the agreed policy framework and undermines the significant gains that have been made throughout the energy market reform process.

Effective governance of the energy markets was rightly identified by both COAG and the MCE as a critical component of an effective regulatory regime and has been the central achievement of the energy market reform program to date. However, governments must now have confidence in the energy sector governance model they created and develop a NGL that sets out the high-level policy framework and leaves

the development of a detailed best-practice, light-handed regulatory model (consistent with the high-level policy framework and market objective) to the independent rule-maker. Similarly, the independence of the rule-maker needs to be protected – giving too broad a discretion to the regulator simply blurs this distinction and increases regulatory risk.

Regulatory risk is a significant deterrent to energy sector investment. The new energy access regime was intended to reduce this risk and “streamline and improve the quality of economic regulation across energy markets to lower the cost and complexity of regulation facing investors and enhance regulatory certainty”. Disproportionate information powers for both the AER and the AEMC (extending to both service providers and associate contracts) only increases this risk along with the cost of compliance.

However, regulatory risk can be mitigated – somewhat – by the right to access an effective merits review regime. Unfortunately, given the rather draconian nature of the proposed national gas legislative framework, the limited merits review model agreed to by the MCE is no longer sufficient or appropriate.

An opportunity now exists to objectively review the national gas legislative package and consider whether it effectively delivers on COAG/MCE’s agreed policies or whether it enshrines an enduring sub-optimal model of regulation.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Brad Page', with a stylized flourish at the end.

Brad Page
Chief Executive Officer