

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.

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.

The role of advisor on coverage matters under the national gas access regime is currently vested in the National Competition Council (NCC).

In the light of the desirability of consistency with the National Access Regime, the MCE has decided that the NCC should retain responsibility for the coverage advisory function.

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.

The NCC will remain the coverage recommendation body 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 the 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), operational 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 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 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 AEMC in consultation with the AER, and reflect an assessment of the relative costs and benefits of applying the different regulatory options to the particular pipeline. The form of the net benefit test and its conduct will be prescribed in the national gas legislation (the net benefit test and its application is further elaborated 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);
- 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 AEMC would apply a net benefit test prescribed in the law to decide the form of regulation that is appropriate for a particular pipeline.

In relation to the net benefit test, it is intended that the legislation will provide the AEMC with clear criteria on the form and conduct of the assessment of the relative costs and benefits of implementing the light-handed option.

The information disclosure requirements under the light-handed option will be developed for the initial National Gas Rules to be made under the proposed National Gas Law. The information disclosure rules will be applied by the AER and, as with other rules, be subject to the rule change process administered by the AEMC on application. It is intended that the rules would provide scope for the disclosure requirements under the light-handed option to be applied in a manner that reflects the particular circumstances of individual pipelines.

Establishing the net benefit test for the light-handed regulatory option in the law, with information disclosure rules to be applied by the AER and administered by the AEMC, will provide certainty to stakeholders and ensure an appropriate separation of the criteria for determining the light-handed option and its application and enforcement.

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 form and conduct of the net benefits test for the light-handed regulatory option will be prescribed in the national gas legislation and the AEMC will apply the test in consultation with the AER 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.

Rules for information disclosure requirements under the light-handed regulatory option will be developed for the initial National Gas Rules and be applied by the AER, and will provide for information disclosure to be tailored to suit the individual circumstances of a particular pipeline.

4.4 Enhancing regulatory certainty for gas pipeline 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 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 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 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 gas transmission pipeline or distribution network will be able to apply to the NCC for an up-front coverage assessment. The NCC will be empowered to conduct such assessments and make a timely recommendation to the designated Minister in respect of a proposed gas pipeline. Upon receiving an NCC 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 NCC 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 NCC 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
- build and operate the pipeline in the market uncovered (in this case, the pipeline may be subject to a future coverage application); or
- make an application under Measure 2 (if the proposed pipeline is an international transmission pipeline).

Measure 2: Price Regulation Exemption

The MCE recognises that the coverage assessment process followed by Ministerial decision on a binding ruling may not be a sufficiently timely process in the context of projects that might bring gas to the Australian energy market from international sources, such as from East Timor, Indonesia or Papua New Guinea. To ensure that the regulatory regime does not inhibit such pipelines proceeding to financial close, the MCE has decided to make available a mechanism for a 15 year price regulation exemption for proposed international gas pipelines which originate in another country and bring gas from a source outside Australia as an additional option to the first measure described above. The MCE believes that Measure 1 and the light handed form of regulation provide sufficiently timely and appropriate mechanisms to promote investment in new pipelines from domestic gas sources when balanced against the concerns of users about potential abuse of market power. The additional incentive for overseas gas accords with Australia's long term energy security needs.

An international pipeline qualifying for the additional option of a price regulation exemption would not be subject to the existing coverage assessment process. It would be 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 exemption within the framework of the gas access regime.

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

Consistent with the above, a pipeline granted a 15 year price regulation exemption would be required to meet certain transparency requirement. These would include:

- establishing a public, non-discriminatory, access policy setting out procedures for negotiating third party access;
- offering non-discriminatory pricing for similar reference services;
- publishing indicative prices and how prices are calculated for what would otherwise be reference services;
- maintaining a register of actual spare capacity; and
- general annual reporting on access negotiations.

These must be published on the company's website. Further details on reporting access negotiations to the regulator will be considered as part of the drafting of the National Gas Law.

The pipeline would also 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;
- The prohibition on preventing or hindering access in s. 13 of the GPAL
- General Regulatory and Miscellaneous Provisions to the extent that they do not relate to pricing matters.

Once a price regulation exemption 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 exemption 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 exemption would continue.

At the end of the 15 year price regulation exemption period, the pipeline would continue to be uncovered, subject to any subsequent coverage application. As well as at any time after the 15 year period, such applications could be made in the period leading up to the end of the 15 year price regulation exemption such that if coverage was recommended, a full access arrangement could be put in place to commence from the end of the price regulation exemption.

A key component of the new greenfields pipeline price regulation exemption regime will be the criteria for determining whether a particular project qualifies for the exemption, and the process under which an application for the exemption is assessed.

Greenfield Criteria for International Transmission Pipelines

A proponent of a transmission pipeline project which has not yet commenced operations and intends to bring gas to Australia from an overseas source through a new pipeline will be able to apply to the Commonwealth Minister and NCC in writing for a decision on whether the pipeline or part of the pipeline is a Greenfield Pipeline. To qualify as a greenfield pipeline, the proposed pipeline could not be covered by an existing access arrangement.

The NCC would conduct a high level assessment of market power and public interest issues with the proposed pipeline (benefits and costs). The NCC would publish non-confidential parts of an application on its website and would be able to consider public submissions on these issues. The NCC would then provide advice on these issues to the Commonwealth Minister within no more than 30 business days.

The Commonwealth Minister would consider the application and NCC advice and make a decision within 10 business days of receiving the advice. The Commonwealth Minister would be able to declare the pipeline to be a Greenfield Pipeline if it meets the criteria unless he or she considers that the advice from the NCC warrants not granting the incentive.

The option for new 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 international greenfield transmission pipelines will be introduced. These pipelines would need to originate in another country and bring gas to Australia from outside of Australian territory and not be covered by an existing access arrangement.

International Greenfield transmission 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) and also non-discriminatory and pricing transparency principles. 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 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 for 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 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 of the various parties, as well as the high level constraints and criteria for the AER and AEMC. The National Electricity Law 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 the development of a national framework for regulating electricity and gas distribution and retail (other than retail pricing), including the release of an Issues Paper in August 2004, and a further consultation paper in October 2005.

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 that 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*.

Accordingly, the MCE commissioned an Expert Panel to advise on a model to achieve a common approach to revenue and network pricing across the energy market.

The terms of reference for the Panel are at Appendix 2. The terms of reference required the Expert Panel 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 was 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 was 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 were 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 was 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 was 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 included:

- 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.

The panel consisted of four members – an economist, a regulatory expert, a lawyer and an eminent chair – and the chair of the AEMC was invited to participate as an observer. The panel was required to release a draft report 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. The final report was delivered to MCE on 13 April 2006. The MCE has considered the Panel's recommendations on a common objects clause in section 4.1 above. Other recommendations of the Panel's report will be addressed in the explanatory material that will accompany the release of an exposure draft of the National Electricity Law and National Gas Law, scheduled for late May 2006.

TABLE FOR MCE DECISION ON THE PRODUCTIVITY COMMISSION (PC) GAS ACCESS REVIEW

5.1	<p><i>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:</i></p> <p><i>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.</i></p>	<ul style="list-style-type: none"> MCE will adopt an overall objects clause for the proposed National Gas Law that is consistent with that in the National Electricity Law, can be applied for retail rule making and similar matters to be regulated under the National Gas Law, and provides clarity as to the policy intent for the gas access regime and coverage decisions under the regime, namely: <p style="text-align: center;"><i>The object of this law is to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety reliability and security of supply of natural gas.</i></p>
5.2	<p><i>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.</i></p>	<ul style="list-style-type: none"> MCE accepts this recommendation.
5.3	<p><i>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:</i></p> <p><i>(a) facilitates the development and operation of a national market for natural gas</i> <i>(b) prevents abuse of market power</i> <i>(c) promotes a competitive market for natural gas in which customers may choose suppliers, including producers, retailers and traders</i> <i>(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</i> <i>(e) provides for the resolution of disputes.</i></p>	<ul style="list-style-type: none"> MCE accepts this recommendation.
5.4	<p><i>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:</i></p> <p><i>(a) the Service Provider’s legitimate business interests and investment in the Covered Pipeline</i> <i>(d) the economically efficient operation of the Covered Pipeline</i> <i>(e) the public interest, including the public interest in having competition in markets (whether or not in Australia)</i> <i>(f) the interests of Users and Prospective Users</i> <i>(g) any other matters that the Relevant Regulator considers are relevant.</i></p>	<ul style="list-style-type: none"> 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) has also considered the drafting of the equivalent provisions to ensure they are consistent with their recommendations on economic regulation.

**TABLE FOR MCE DECISION ON THE PRODUCTIVITY COMMISSION (PC) GAS ACCESS REVIEW
MAY 2006
PC RECOMMENDATIONS AND RESPONSE**

No.	PC Recommendation	Response
5.5	<p><i>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:</i></p> <p><i>(a) the Service Provider's legitimate business interests and investment in the Covered Pipeline</i></p> <p><i>(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</i></p> <p><i>(c) the economic value to the Service Provider of any additional investment that the Prospective User or the Service Provider has agreed to undertake</i></p> <p><i>(d) the interests of all Users</i></p> <p><i>(g) the economically efficient operation of the Covered Pipeline</i></p> <p><i>(h) the benefit to the public from having competitive markets.</i></p>	<ul style="list-style-type: none"> • 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) has also considered the drafting of the equivalent provisions to ensure they are consistent with their recommendations on economic regulation.
5.6	<p><i>An additional factor should be added to s.6.15 of the Gas Code, as follows:</i></p> <p><i>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).</i></p>	<ul style="list-style-type: none"> • MCE accepts this recommendation and notes the final details of the revised s.8.1 are to be finalised following consideration of the recommendations of the Expert Panel (Refer to Recommendation 7.11).
6.1	<p><i>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.</i></p>	<ul style="list-style-type: none"> • MCE accepts this recommendation.
6.2	<p><i>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:</i></p> <p><i>(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.</i></p>	<ul style="list-style-type: none"> • MCE accepts this recommendation.

**TABLE FOR MCE DECISION ON THE PRODUCTIVITY COMMISSION (PC) GAS ACCESS REVIEW
MAY 2006
PC RECOMMENDATIONS AND RESPONSE**

No.	PC Recommendation	Response
6.3	<i>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.</i>	<ul style="list-style-type: none"> • 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 AEMC, and reflect an assessment of the relative costs and benefits of applying the alternate regulatory options to a particular pipeline. There will be clear criteria in the National Gas Law 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	<p><i>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.</i></p>	<ul style="list-style-type: none"> • See the response to recommendation 6.3.
6.5	<p><i>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:</i></p> <p><i>(a) the nature of demand for the commodities and services of end users of gas</i> <i>(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</i> <i>(c) the nature and extent of any barriers to entry in the market</i> <i>(d) the degree of countervailing power in the market</i> <i>(e) the degree of horizontal and vertical integration</i></p>	<ul style="list-style-type: none"> • See the response to recommendation 6.3.

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	<p><i>(f) any other significant factors, subject to them being consistent with the proposed new objects clause.</i></p> <p><i>In determining the potential costs of either form of regulation, the following matters should be taken into account:</i></p> <p><i>(a) direct costs of service providers, governments and users</i></p> <p><i>(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))</i></p> <p><i>(c) any other significant factors, subject to them being consistent with the proposed new objects clause.</i></p>	
6.6	<p><i>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.</i></p>	<ul style="list-style-type: none"> • MCE accepts this recommendation. • MCE notes that the Australian Government has introduced legislation to amend the <i>Trade Practices Act 1974</i> to remove the possibility of ‘forum shopping’ between the National Access Regime and Gas Access Regime.
7.1	<p><i>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:</i></p> <p><i>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:</i></p> <p><i>(a) that reference tariffs should:</i></p> <p><i>(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</i></p> <p><i>(ii) include a return on investment commensurate with the regulatory and commercial risks involved</i></p> <p><i>(b) that reference tariff structures should:</i></p> <p><i>(i) allow multi-part pricing and price discrimination when it aids efficiency</i></p> <p><i>(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 to the extent that the cost of providing access to non-associates is higher</i></p> <p><i>(c) that reference tariffs should be set so as to provide incentives to reduce costs or otherwise improve productivity.</i></p>	<ul style="list-style-type: none"> • MCE accepts the merit of many of the recommendations relating to pricing principles, regulatory guidance and related matters in chapter 7 of the PC report. For reasons elaborated in Section 5 of the Decision Paper, the MCE has commissioned an Expert Panel to advise on a model to achieve a common approach to revenue and network pricing across the energy market. Recommendations 7.1 – 7.13 were therefore referred to the Expert Panel for advice in that context. The MCE will provide a substantive response to Recommendations 7.1 – 7.13 in its decision on the recommendations of the Expert Panel.

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7.2	<p><i>To ensure there is no conflict with the pricing principles specified in recommendation 7.1, the following should be deleted from the Gas Code:</i></p> <ul style="list-style-type: none"> <input type="checkbox"/> <i>the overview in italics at the beginning of s.8</i> <input type="checkbox"/> <i>ss8.2(c), 8.3(a), 8.38–8.43 and 8.45.</i> 	<ul style="list-style-type: none"> • See response to Recommendation 7.1.
7.3	<p><i>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:</i></p> <p><i>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):</i></p> <p><i>And s.8.46 of the Gas Code should be changed to:</i></p> <p><i>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.</i></p>	<ul style="list-style-type: none"> • See response to Recommendation 7.1.
7.4	<p><i>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:</i></p> <p><i>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.</i></p>	<ul style="list-style-type: none"> • See response to Recommendation 7.1.
7.5	<p><i>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:</i></p> <p><i>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 objective of the Gas Access Regime.</i></p>	<ul style="list-style-type: none"> • See response to Recommendation 7.1.
7.6	<p><i>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</i></p>	<ul style="list-style-type: none"> • See response to Recommendation 7.1.

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	<i>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.</i>	
7.7	<i>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.</i>	<ul style="list-style-type: none"> • See response to Recommendation 7.1.
7.8	<p><i>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:</i></p> <p><i>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.</i></p> <p><i>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);</i></p> <p><i>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).</i></p>	<ul style="list-style-type: none"> • See response to Recommendation 7.1.
7.9	<p><i>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 the following:</i></p> <p><i>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.</i></p> <p><i>The role of the Relevant Regulator is therefore to assess whether the Service Provider's:</i></p>	<ul style="list-style-type: none"> • See response to Recommendation 7.1.

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	<p><i>(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.</i></p>	
7.10	<p><i>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).</i></p>	<ul style="list-style-type: none"> • See response to Recommendation 7.1.
7.11	<p><i>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.</i></p>	<ul style="list-style-type: none"> • MCE accepts the recommendation to commission a study, noting the Expert Panel has reviewed and reported on a broader range of matters than that recommended under 7.11. See response to Recommendation 7.1 and the Terms of reference for the Expert panel.
7.12	<p><i>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.</i></p>	<ul style="list-style-type: none"> • See response to Recommendation 7.1.
7.13	<p><i>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 between different reference services (where there is more than one) or between users.</i></p>	<ul style="list-style-type: none"> • See response to Recommendation 7.1.
7.14	<p><i>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.</i></p>	<ul style="list-style-type: none"> • 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) which will be endowed with adequate and appropriate information gathering powers will largely solve the problem of multiple collection powers for jurisdictions other than Western Australia.
7.15	<p><i>Section 3.16 of the Gas Code should be amended so that it unambiguously clarifies that any</i></p>	<ul style="list-style-type: none"> • This issue will be progressed in the drafting of the National

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	<i>expansion of a covered pipeline will also be covered.</i>	Gas Law and National Gas Rules.
8.1	<i>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.</i>	<ul style="list-style-type: none"> • 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 AEMC, in consultation with the AER and reflect an assessment of the relative costs and benefits of applying the alternate regulatory options to a particular pipeline. Clear criteria about the form and conduct of the cost-benefit assessment, taking into account the PC recommendations on this matter will be in the National Gas Law (see recommendations 6.4 and 6.5 above).
8.2	<p><i>The proposed monitoring form of regulation to be incorporated into the Gas Access Regime should have the following features:</i></p> <ul style="list-style-type: none"> <input type="checkbox"/> <i>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</i> <input type="checkbox"/> <i>subjecting service providers to provisions for anticompetitive conduct (the current s.13 of schedule 1 of the Gas Pipelines Access Law)</i> <input type="checkbox"/> <i>minimum ring fencing provisions</i> <input type="checkbox"/> <i>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)</i> <input type="checkbox"/> <i>scope for the service provider to adopt, at its discretion, additional features, such as a voluntary code of conduct.</i> 	<ul style="list-style-type: none"> • The MCE will implement a variant on this recommendation, namely: <ul style="list-style-type: none"> • 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.
8.3	<p><i>The access policy prescribed by service providers under the proposed monitoring regime should include at a minimum:</i></p> <ul style="list-style-type: none"> <input type="checkbox"/> <i>processes for negotiating access</i> <input type="checkbox"/> <i>dispute resolution procedures (including provision for binding commercial arbitration).</i> 	<ul style="list-style-type: none"> • The National Gas law will make use of the Gas Code dispute resolution procedures and the process for negotiating access under the monitoring form of regulation will be developed for the initial National Gas Rules .
8.4	<i>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).</i>	<ul style="list-style-type: none"> • MCE accepts this recommendation.

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8.5	<i>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.</i>	<ul style="list-style-type: none"> • MCE accepts this recommendation.
8.6	<p><i>Under the proposed monitoring regime, information disclosure requirements should involve:</i></p> <ul style="list-style-type: none"> <input type="checkbox"/> <i>focusing more on trend performance, including profitability</i> <input type="checkbox"/> <i>reporting and monitoring after the event, without any need for prior endorsement by the regulator</i> <input type="checkbox"/> <i>the regulator particularly recording cases where access negotiations have been unsuccessful.</i> 	<ul style="list-style-type: none"> • MCE accepts this recommendation. Rules for the operation of the monitoring function will be developed, and information disclosure rules will be developed for the initial National Gas Rules.
8.7	<i>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 example) to update the guidelines when substantive need arises.</i>	<ul style="list-style-type: none"> • MCE accepts this recommendation in part. Information disclosure rules, to be applied by the AER, will be developed for the initial National Gas Rules, and the AEMC will be responsible for the ongoing administration of the rules under the National Gas Law.
8.8	<i>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.</i>	<ul style="list-style-type: none"> • MCE does not accept this recommendation at this stage. Information provisions and rules for the operation of the monitoring function will be developed for the initial National Gas Rules.
8.9	<p><i>To ensure the data disclosed by service providers under the proposed monitoring regime are accurate:</i></p> <ul style="list-style-type: none"> <input type="checkbox"/> <i>chief executive officers (CEOs) should be required to sign a declaration stating that the data are true</i> <input type="checkbox"/> <i>financial information and financial performance measures should be certified by an auditor</i> <input type="checkbox"/> <i>financial penalties should be available through the courts if companies refuse to provide the</i> 	<ul style="list-style-type: none"> • MCE accept the requirement for appropriate verification of data to be provided to the Regulator by service providers. The issue of what is the appropriate level of verification for the potentially differing requirements will be considered further in the development of the initial National Gas Rules for the operation of the monitoring function.

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	<i>required monitoring data within the established deadlines.</i>	
8.10	<i>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.</i>	<ul style="list-style-type: none"> • The AEMC will determine the form of coverage and if the light-handed form is applied, the pipeline will remain on the light-handed form of regulation subject to the requirements continuing to be met. Rules for the operation of the monitoring function will be developed for the initial National Gas Rules. • MCE accepts the recommendation that any person may apply for revocation of coverage of a monitored pipeline at any time.
8.11	<i>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.</i>	<ul style="list-style-type: none"> • MCE does not accept this recommendation. There should be no restriction on applications to the AEMC for a shift from the monitoring form of regulation to full regulation. Any affected person should be able to make application.
8.12	<i>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.</i>	<ul style="list-style-type: none"> • MCE accepts the recommendation in part. The AEMC will determine the form of regulation. Rules for the operation of the monitoring function will be developed for the initial National Gas Rules.
8.13	<i>To remove uncertainty, pending a decision by the Minister following a recommendation from 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.</i>	<ul style="list-style-type: none"> • This issue is being addressed in the context of the response to the PC review of the national access regime.
9.1	<i>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.</i>	<ul style="list-style-type: none"> • MCE accepts this recommendation. MCE will also introduce price regulation exemptions for international greenfield transmission pipelines.

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9.2	<i>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.</i>	<ul style="list-style-type: none"> • This matter is being addressed separately by the Commonwealth.
10.1	<i>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.</i>	<ul style="list-style-type: none"> • 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	<i>The associate contract provisions should be amended to clarify that these provisions do not apply to asset management contracts.</i>	<ul style="list-style-type: none"> • 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	<p><i>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:</i></p> <p><i>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 Covered Pipeline must (if requested by the Relevant Regulator):</i></p> <p><i>(a) establish and maintain a separate set of accounts in respect of the Services provided to the Covered Pipeline</i></p> <p><i>(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.</i></p> <p><i>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.</i></p>	<ul style="list-style-type: none"> • 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.
10.4	<p><i>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:</i></p> <p><i>s.4.2A In complying with ss4.1B(a) and (b) an Associate of a Service Provider must:</i></p> <p><i>(a) if the Relevant Regulator has published general accounting guidelines for Associates</i></p>	<ul style="list-style-type: none"> • 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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	<p><i>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.</i></p> <p><i>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.</i></p>	
10.5	<p><i>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’.</i></p>	<ul style="list-style-type: none"> • MCE accepts this recommendation.
11.1	<p><i>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.</i></p>	<ul style="list-style-type: none"> • 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.
11.2	<p><i>The Gas Access Regime should be amended whereby the ‘further final decision’ should be removed from the approval process for access arrangements.</i></p>	<ul style="list-style-type: none"> • See response to Recommendation 11.1.
11.3	<p><i>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.</i></p>	<ul style="list-style-type: none"> • See response to Recommendation 11.1.
11.4	<p><i>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.</i></p>	<ul style="list-style-type: none"> • A MCE SCO consultation paper has been released to canvass views on the issue of merit review principles and the decisions under the National Electricity Law and National Gas Law which may be appropriate for merits review.
11.5	<p><i>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.</i></p>	<ul style="list-style-type: none"> • See response to Recommendation 11.4.
12.1	<p><i>The agency that recommends coverage of a pipeline, should also be responsible for</i></p>	<ul style="list-style-type: none"> • MCE accepts this recommendation in part. The NCC will be

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No.	PC Recommendation	Response
	<i>recommending the form of regulation to apply to the pipeline.</i>	the coverage advisory body and the AEMC will determine the form of regulation for covered pipelines.
12.2	<i>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).</i>	<ul style="list-style-type: none"> • The MCE accepts this recommendation in part. The agency who will advise on coverage (NCC) will be separate from the agency administering that regulation.

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

Terms of reference

Review of Revenue and Network Pricing across the Energy Market

Background

The Ministerial Council on Energy (MCE) agreed on 4 November 2005 to establish an Expert Panel to advise on a model to achieve a common approach to revenue and network pricing across the energy market. This terms of reference sets out the full extent of that work.

Role of the Expert Panel

The principal role for the Panel is to develop a common set of arrangements for economic regulation of access to electricity and gas transmission and distribution networks, covering:

- Pricing principles;
- Regulatory guidance (ie, how the principles are applied, the extent of the regulator's discretion, and related matters); and
- Any associated changes necessary to established regulatory processes (ie, the steps in the assessment process, timelines, etc.).

The Panel should provide a final Report to the MCE giving high level policy guidance and recommendations on pricing principles and regulatory methodologies suitable for inclusion in a national energy access regime.

Relevant matters for consideration

The Panel should note that a key objective of the MCE's energy market reform program is to ensure that, where the decision has been made to impose price regulation, costs are kept to a minimum while maintaining the effectiveness of regulation in achieving the objectives of the National Electricity Law (NEL) and National Gas Law (NGL). In determining a common approach to revenue and network pricing, it will be important to consider what high level direction should be given to the regulator and whether this should be in the law or in the rules.

The Panel should note also MCE decisions that in performing or exercising any economic regulatory function or power (which includes but is not limited to revenue and network pricing), the Australian Energy Regulator (AER) will be required to perform or exercise that function or power in a manner that will, or is likely to contribute to the achievement of the national electricity market objective (see s. 16(1)(a) of the NEL) or gas access objective (a similar requirement is likely to be imposed in the proposed National Gas Legislation).

The Panel should note also that the MCE has agreed that part of the common approach to energy access under the *Trade Practices Act 1974* will be that the national electricity and gas access regimes will be certified under s. 44N of the *Trade Practices Act 1974* and will remain effective access regimes. The criteria on whether a regime can be certified are in clause 6 of the

Competition Principles Agreement. Further to the Australian Government's response to the Productivity Commission's Review of the National Access Regime, the Trade Practices Amendment (National Access Regime) Bill 2005 will make the proposed objects clause of the National Access Regime relevant for certification. The Australian Government's response to that Review also proposes inclusion of the pricing principles for the National Access Regime in the criteria for certification in the Competition Principles Agreement. Consequently, the Panel's work should consider how the revenue and network pricing principles can be applied to the energy sector in a workable and appropriate way such that certification requirements can be met.

Matters for review

In undertaking the review of revenue and network pricing, the principal objective for the Panel should be to develop appropriate criteria for determining the level of prescription in the law and subsidiary rules for a common energy access pricing model.

The Panel's advice should include the scope for the law and statutory rules on access pricing to be common across all electricity and gas transmission and distribution. The advice should identify those areas where technology, market circumstances or other factors may necessitate distinctions between electricity and gas and/or between transmission and distribution sectors.

Matters to be addressed in developing the Panel's advice should include:

- The form of price control and guidance;
- CPI-X building block revenue control;
- Potential alternatives to the building block methodology, including TFP and an evaluation of the circumstances in which each methodology may be appropriate;
- Incentive arrangements for reliability;
- The scope of the regulator's discretion (including propose/respond models);
- The scope of regulation (ie services to be regulated, service definitions, reliability mechanisms etc);
- Regulatory procedures; and
- The appropriate scope of the regulator's information gathering powers for economic regulation.

The Panel's report in making recommendations on these issues should also provide the MCE with specific proposed responses to any recommendations of the Productivity Commission's Review of the Gas Access Regime which are explicitly referred to the Panel in the MCE response.

Relevant Considerations

The MCE's objective is consistency and harmonisation between the electricity and gas access regimes such that investment in, and use of, energy is not distorted by differing regulatory regimes. With this aim in mind the Panel should take into account all of the relevant existing access models, related reform programs and recommendations in relevant reports. Relevant reports include:

- 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 and the provisions of the Trade Practices Amendment (National Access Regime) Bill 2005;
- The objects clause and 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 NEL 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;
- The AER Compendium of Transmission Guidelines;
- The ACCC's Statement of Regulatory Principles;
- Australia's Export Infrastructure (Report to the Prime Minister by the Exports and Infrastructure Taskforce May 2005);
- NECA transmission and distribution pricing reviews and related ACCC authorisations;
- The *Electricity Networks Access Code 2004* developed under the *Electricity Industry (Western Australia) Act 2004*; 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, it is not intended that the Panel revisit the following matters:

- the objects clause currently contained in the NEL and the proposed objects clause for the National Gas Law as set out in the MCE Decision on the Government Response to the Productivity Commission's review of the National Gas Access Regime (except to the extent that a single but equivalent objective could cover the whole energy sector);
- the MCE's response to the Productivity Commission's Review of the Gas Access Regime including the measures to increase regulatory certainty for greenfields projects;
- the existence of the current coverage test for gas infrastructure;
- the certification criteria under Section 44N of the *Trade Practices Act 1974*;
- the MCE's decisions on the availability of review mechanisms in the gas and electricity regulatory frameworks (when agreed); and

- the enforcement provisions as set out in the NEL and already drafted for the NGL.

Process and Timing

The Panel is requested to develop a draft report on the matters in these terms of reference for public consultation in early February 2006 and a final report to the MCE in early March 2006.

This timeframe is to meet the MCE timetable for the development of the national gas legislation in the first half of 2006. At this time, the NGL has been scheduled for public exposure by the end of March 2006. The Panel will be kept informed of any amendments to the timing of the NGL.
