

2 January 2007

Manager, MCE Secretariat
Department of Industry, Tourism and Resources
GPO Box 9839
Canberra ACT 2601

Dear Sir/Madam

Response to the Exposure Draft of the National Gas Law

Integral Energy welcomes the opportunity to respond to the Exposure Draft of the National Gas Law (draft NGL) and the 2006 Legislative Package: Gas Framework (the NGL Framework paper) prepared by the Standing Committee of Officials (SCO) of the Ministerial Council on Energy (MCE).

General Comments

The draft NGL contains numerous provisions which would more appropriately reside in the National Gas Rules (NGR). It is noteworthy that the draft NGL is over 300 pages whilst the NGR (which would be expected to provide the detail implementing the provisions) is 23 pages only. Whilst this provides greater certainty to all parties, it is essential to ensure that the provisions in the draft NGL meet the policy intent of the MCE otherwise poor market policy prescriptions are hardwired into law. By incorporating provisions in the draft NGL rather than the NGR, the timeliness, transparency and likelihood of effecting future amendments is significantly restricted.

Further, the inclusion of inappropriate prescriptive provisions in the draft NGL diminishes flexible administration, market development and responsiveness and effective implementation of gas market policies and laws. Similarly, the omission of provisions in the draft NGL necessary to give regulatory certainty to market participants increases the risks and costs of market participants and fails best practice regulation. These provisions are discussed in further detail in the ENA submission on the draft NGL and in the following specific comments on the draft NGL.

Specific Comments

Revenue and Pricing Principles

Section 21 of the draft NGL sets out the revenue and pricing principles to be applied to service providers. In its report to the MCE, the Expert Panel recommended that the “*NGL include common network pricing principles and that these be based on section 35 of the NEL.*”¹

Generally, Integral Energy notes that the provisions of s21 of the draft NGL depart from the more prescriptive requirement for common network pricing principles that ‘must’ be applied in section 35 of the NEL by substituting them with common network pricing principles that ‘should’ be applied. If the intention of the draft NEL is to ensure these common network pricing principles are applied, Integral Energy submits that the use of the word ‘should’ in s21 of the draft NGL be replaced with the word ‘must’, as it provides a clear definitive word which removes any doubts as to the discretion associated with its application.

Section 21(4) of the draft NGL provides that “*allowance should be made for the value of a pipeline by means of which a service provider provides reference services*”. Whilst the definition of a ‘pipeline’ includes a proposed pipe or system of pipes, the provision appears to unintentionally provide a temporal context in that it applies only to a pipeline which currently provides reference services.

To ensure that the allowance for the value of a pipeline includes those proposed pipelines which are not yet fully operational, and to achieve consistency with s35 of the NEL, Integral Energy submits that s21(4) of the draft NGL be amended to read “*allowance must be made for the value of a pipeline by means of which a service provider provides, or is to provide, reference services*”.

This temporal context also extends to other provisions of section 21 of the draft NGL which also need to be amended to ensure investor certainty and consistency with the NEL.

Section 21(5) of the draft NGL requires that regard should be had to any previous access arrangement final decision or a decision of a relevant regulator under section 2 of the Gas Code in considering any valuation of a pipeline. This provision significantly departs from both the express wording recommended by the Expert Panel in paragraph 6.5.2(d) of their report and the provisions for valuation of assets in s35(d) of the NEL. The provisions omits any consideration of jurisdiction gas legislation regulating the revenue earned, or prices charged, by a regulated gas system operator in respect of services provided by it that were regulated under the Gas Code or that legislation.

Accordingly, Integral Energy recommends s21(5)(b) be amended to read “*a determination or decision under the Gas Code or jurisdictional gas legislation regulating the revenue earned, or prices charged, by a regulated gas system operator in respect of services provided by it that were regulated under the Gas Code or that legislation.*”

Alternatively, Integral Energy submits that the provisions in s 21 of the draft NGL be amended to the wording expressly recommended by the Expert Panel in paragraph 6.5.2 of their report² and which better reflects uniformity with the provisions contained in s35 of the NEL.

¹ Report to the Ministerial Council on Energy, Expert Panel on Energy Access Pricing, April 2006, p116

² Report to the Ministerial Council on Energy, Expert Panel on Energy Access Pricing, April 2006, p117

“Propose-respond” model

Section 24 of the draft NGL contains a presumption against the “propose-respond” model under the NGL, unless the Rules provide otherwise. The NGL Framework paper states the provisions of s24 of the draft NGL “*gives effect to the Expert Panel’s conclusion that the Law should not embody a presumption in favour of accepting a regulated entity’s proposed access arrangement*³”.

In its recommendations to the MCE, the Expert Panel states:

*“the Panel concludes that it is not appropriate for a global presumption to be adopted in the Law or the Rules in favour of the regulator accepting a regulated entity’s proposal. Equally, the Panel concludes that it is not appropriate for the Law to mandate a receive-respond model. The complexity and differing characteristics of each element of the service provider’s proposal are such that the Law cannot itself prescribe a single overriding test to be applied by the AER in assessing service provider proposals. These must be determined by the AEMC in the Rules developed for each of the alternative available forms of regulation.”*⁴

As presently drafted, the inclusion of an express presumption against the “propose-respond” model in the draft NGL and the exclusion of any express presumption against the “receive-respond” model in the draft NGL, would appear to provide a misleading application of the Expert Panel’s recommendations. To ensure a balanced application of the Expert Panel’s recommendations, Integral Energy submits that s24 of the draft NGL be amended to ensure the full substance of the Expert Panel’s recommendations with respect to a “fit for purpose” model are implemented.

Functions and Powers of the AER

Section 26 of the Draft NGL provides that “*the AER has the power to do all things necessary or convenient to be done for or in connection with the performance of its functions.*”

Integral Energy considers that it is appropriate for the AER to have the necessary power to properly perform its functions. However, Integral Energy considers that it is contrary to good public policy, unnecessary and inappropriate for the AER to have an unfettered discretion to do all things ‘convenient’ in performing its functions. Accordingly, Integral Energy submits that s26 of the draft NGL be amended to read “*the AER has the power to do all things necessary to be done for or in connection with the performance of its functions*”.

Total Factor Productivity

Section 70(2) of the draft NGL provides that the AEMC may make a Rule for the application of total factor productivity (TFP) as a regulatory economic methodology to inform and assist the AER in applying or analysing the application of the building blocks approach methodology for making or approving an access determination and approving variations.

Integral Energy considers that a TFP methodology would be best developed in consultation with industry in a transparent manner with a view to its future application as an alternative to adopting a building blocks approach methodology.

³ 2006 Legislative Package: Gas Legislative Framework, Standing Committee of Officials of the Ministerial Council on Energy, November 2006, p10

⁴ Report to the Ministerial Council on Energy, Expert Panel on Energy Access Pricing, April 2006, p90

Integral Energy considers that it is contrary to good public policy and increases significant regulatory uncertainty for a regulator to develop a TFP methodology separately or in isolation and legislatively use that TFP methodology in determining a building block based determination.

Further, s70(2) of the draft NGL is contrary to the express recommendations of the Expert Panel which provided that the AEMC make Rules which address the *“mechanisms or methodologies for the derivation of the maximum allowable revenue or prices to be applied by the AER in making a network pricing determination, which may include –*

- (a) the use of a building block approach; or*
- (b) the use of a total factor productivity approach.⁵”*

The Expert Panel further recommended that the MCE direct the AEMC to undertake a review, by 31 December 2008, that addresses the circumstances in which the application of a TFP-based price setting methodology would contribute to the NEL and NGL objectives, data collection arrangements and the development of draft Rules to support the application of a TFP based form of control for any individual or group of electricity or gas distribution or transmission service providers.⁶

Accordingly, Integral Energy submits that s70(2) of the draft NGL be deleted.

NGL Objective

The NGL Framework paper prepared by the SCO states that the *“MCE sees alignment between the objectives of the gas and electricity regimes as being an important foundation for the regimes”* and that *“the National Electricity Law objective will similarly be amended to make the current market objective an objective of that Law”⁷.*

Expanding on the benefits of a common objective, the NGL Framework paper states:

“a common objective for both the NGL and NEL will provide guiding principle in relation to all aspects of the regime where discretions are required to be exercised and interpretations to be made. Administrative bodies (including Ministers) will have to ensure that their regulatory decisions are consistent with the objectives of the NGL and NEL, and the AEMC will have to test any future Rule changes against the objectives of the NGL and the NEL when making Rules”⁸.

Therefore, it is surprising that the objective of the draft NGL is inconsistent with the objective of the National Electricity Market (NEM), in that it omits any reference to the natural gas system.

The national gas objective is stated in s20 of the draft NGL as follows:

“The objective 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.”

⁵ Report to the Ministerial Council on Energy, Expert Panel on Energy Access Pricing, April 2006, p115

⁶ Report to the Ministerial Council on Energy, Expert Panel on Energy Access Pricing, April 2006, p117

⁷ 2006 Legislative Package: Gas Legislative Framework, Standing Committee of Officials of the Ministerial Council on Energy, November 2006, p8.

⁸ 2006 Legislative Package: Gas Legislative Framework, Standing Committee of Officials of the Ministerial Council on Energy, November 2006, p8

Section 7 of the National Electricity Law provides that:

*“The national electricity market objective is to promote efficient investment in, and efficient use of, electricity services for the long term interests of consumers of electricity with respect to price, quality, reliability and security of supply of electricity **and the reliability, safety and security of the national electricity system.**”* (my emphasis)

The second limb of the NEM objective differentiates a service provided through infrastructure and the infrastructure itself. This second limb of the NEM objective was inserted to clearly address specific concerns of investors and market participants with respect to the regulatory framework, in particular the development of future Rules and the implementation of economic regulation.

Whilst recognising the significant impact of the NGL objective in future Rule changes, and decisions by regulators, Courts and other review bodies, the NGL Framework paper fails to provide any commentary or reasons on why the NGL objective departs from the objective in the NEL.

The Expert Panel presumed that the references in the second limb of the NEM objective in the NEL to safety and security of the system was due to the role of NEMMCO and jurisdictional co-ordinators, and observed that at present there was no equivalent in the gas regime⁹. However, the Expert Panel did not comment on the reliability element of the second limb in the objects clause or the role of jurisdictions in setting reliability standards for infrastructure. Rather they suggested that these issues may warrant a change to the objects clause as they are introduced or the regulator be required to consider additional factors.

As presently constructed, the national gas objective in the draft NGL does not expressly provide for any current or future jurisdiction legislation relating to reliability or safety and security of a pipeline similar to the second limb of the NEM objective.

Given the MCE’s stated goal of uniform energy regulation, the Expert Panels’ conclusion that a common objects clause for the NGL and NEL would have significant benefits in developing a common approach to revenue and network pricing across the energy sector, and to enhance regulatory certainty and consistent application of energy regulation, Integral Energy submits that the national gas objective of the NGL should be amended to include an express reference to the reliability, safety and security of the national gas system similar to that in the NEM objective.

Merits Review

Integral Energy strongly supports a robust merits review to ensure the confidence of all parties in a regulatory system. Given the very broad discretions conferred on the regulator in the draft NGL, it is essential that a merits review is capable of ensuring proper accountability for regulatory decisions. The merits review arrangements specified in the draft NGL appear to exclude a number of fundamental elements required to achieve transparency, consistency and quality of regulatory decisions.

⁹Report to the Ministerial Council on Energy, Expert Panel on Energy Access Pricing, April 2006, p39

Whilst the NGL Framework paper identifies certain decisions as being reviewable¹⁰, s272 of the draft NGL provides that they be prescribed by Regulation. In order to provide regulatory certainty to investors and market participants, Integral Energy submits that “reviewable regulatory decisions” should be specified in the NGL.

Section 275(a) of the draft NGL requires that the Australian Competition Tribunal cannot grant leave to appeal about the revenue of a service provider unless the issue to be determined relates to an amount specified in or derived from the decision and that it exceeds the lesser of \$5 million or 2% of the average annual regulated revenue (AARR). As presently drafted, it is unclear whether this threshold is cumulative, in that it may comprise a number of decisions in the determination the total of which exceeds \$5 million or 2% of the AARR.

However, s278(1)(b) of the draft NGL relating to the grounds for appeal, would suggest that the threshold in s275(a) is intended to be cumulative as it provides that a ground for appeal would arise from a combination of errors which combined were material to the making of the decision. Therefore, an amendment to the NGL or a note in the explanatory memorandum stating that this threshold is intended to be a cumulative threshold would assist clarity of this provision.

Should you wish to discuss any of the matters raised in this submission please contact Mr Erik Beerden, Regulatory Affairs Manager, on telephone number (02) 9853 6904.

Yours faithfully

A handwritten signature in black ink that reads "Karen Waldman". The signature is written in a cursive style. To the right of the signature is a vertical red line.

Karen Waldman
Acting Chief Executive Officer

¹⁰ 2006 Legislative Package: Gas Legislative Framework, Standing Committee of Officials of the Ministerial Council on Energy, November 2006, p 29