

## **Consultation on the MCE Response to the Review of the National Gas Access Regime**

### **I. Introduction**

1.1 TRUenergy's position on the Ministerial Council of Energy (MCE)'s response to the Productivity Commission's (PC) Review of the Gas Access Regime is it supports:

- The PC model of price monitoring for transmission pipelines.
- The PC model of promoting an up-front binding ruling of whether a proposed pipeline would pass the 'coverage' test.
- The concept of 15-year access holidays for Greenfield gas transmission pipelines.

1.2 Let me outline the some key reasons why:

- The PC' price monitoring approach represents a superior approach to the alternative model because it has been carefully developed to apply the right level and form of regulation under different market circumstances. It is designed with appropriate checks and balances, That is,

- (i) It defaults to the PC's price monitoring approach to regulating transmission pipelines that satisfy the 'coverage' test in the Gas Code.
- (ii) The light-handed form of regulation applied at this point, represents the appropriate form of light-handed regulation.. It requires pipeline owners to
  - Provide the regulator with an access policy
  - Comply with anti competitive conduct provisions
  - Comply with the ring fencing requirements in the Gas Code.
  - Disclose information to the regulator according to guidelines set by the NCC.
  - The CEO would audit information provided under price monitoring.

The NCC would develop the guidelines required to develop the PC's model of price monitoring. TRUenergy would not expect these guidelines to be anywhere near as exhaustive as the requirements under cost based regulations currently in the Gas Code.

- (iii) It will only apply heavy-handed cost based regulation where it is satisfied that there is a 'net-market' benefit in doing so at this point of proceedings. Hence, it has been designed to limit the application of cost based regulation fully aware of its chilling impact on investment.
  - (iv) If the pipeline owner restricts access or monopoly prices under the PC price motoring approach, then it will be subject to the threat of heavy-handed regulation.
- The alternative price-monitoring model appears to apply the law under sect.1.9 of the Gas Code in an illogical manner. That is, it recommends a pipeline be regulated (under price monitoring) where it fails the 'coverage' tests under Section 1.9 of the Gas Code. Thus, it expands the hand of regulation through price monitoring to transmission pipelines that have been shown not to have significant market power under the Gas Code.
  - The PC's price monitoring approach has been developed after an extensive consultation process with industry, government, regulators and key stakeholders that formed part of the extensive process. As such, the PC has applied a thorough analysis before the model was recommended. The alternative model has not had the same level of rigour applied to it before being recommended for gas.
  - The PC's price monitoring approach in conjunction with minor changes to the Competition Principles Agreement would constitute an "effective access regime" according to the PC..

- The PC's model of promoting an up-front binding ruling of whether a proposed pipeline would pass the 'coverage' test provides protection for investors from the in-efficiencies of regulating these pipelines. Fifteen-year access holidays provide the same outcome. As such, TRUenergy supports both these policy positions.

## 2. The price monitoring model recommended by the PC

2.1 A key finding in the PC's review of the Gas Access Regime was for the potential of heavy handed cost based regulation to impose significant costs for owners, and the potential to distort investment. On page 22 of the PC's Inquiry Report "Review of the Gas Access Regime" this major finding is listed it is noted that

*" The current Gas Access Regime, in effect, is a form of cost -based regulation. While generating benefits, **its significant costs include the potential to distort investment.**"*

In light of this finding, the PC has designed a regulatory scheme that minimises pipeline owners exposure to 'cost based' regulation, where it is able to do so, and substitute this with a form of light-handed regulation.

2.2 The key features of the PC's price monitoring regime include:

- a) Applying Section 1.9 of the Gas Code that reflects the market power test. If the pipeline passes this test then it will be regulated.
- b) It will then be subject to the PC's price monitoring <sup>1</sup>approach which represents an appropriate level and form of regulation at this stage of proceedings..
- c) The PC model then applies a 'net benefit' test to determine whether a heavy-handed building block approach is required. Hence, of paramount importance is the opportunity to apply a light handed form of regulation where it is appropriate to do so in this process. If there is no 'net benefit' in applying heavy-handed cost based regulation to a transmission pipeline, then it will apply its price monitoring approach. Hence, in the PC model of price monitoring, the methodology seeks to apply a light handed approach to regulation where it is possible, because it is clearly aware of the potential impact on investment of the heavy handed cost-based regulation applied under the Gas Code.

2.3 This approach is consistent with the PC's recommendation on the threshold for the 'coverage' test. Its recommendation is to amend the 'coverage' test for pipelines so that 'coverage' of a pipeline is applied where there is a 'material' increase in competition. Hence, the PC's model of access regulation has increased the threshold test for 'coverage' ever conscious of the impact that heavy-handed cost based regulation and its impacts.

2.4 The PC's model of price monitoring has been applied after extensive consultation with stakeholders including industry, regulators, the government and other interested parties. Its price-monitoring model has been developed after an extensive evaluation/ consultation period on a wide range of issues. We believe it delivers benefits including:

- The significant reductions of regulatory risk and offer the investor high certainty and a greater pre-investment understanding of the regulatory environment.
- Low levels of regulatory intervention in price setting means there is less opportunity for regulatory error
- The workable competitive market maximises welfare to the customer by encouraging price service offerings that best meet customer needs
- It best encourages commercial negotiations for market based outcomes

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<sup>1</sup> The PC's price monitoring approach represents an appropriate substitute to cost based regulation for pipelines that pass the 'coverage' test at this stage of proceedings. It requires pipeline owners to

- Provide the regulator with an access policy
- Comply with anti competitive conduct provisions
- Comply with the ring fencing requirements in the Gas Code
- Disclose information to the regulator according to guidelines set by the NCC.
- The CEO would audit information provided under price monitoring

2.5 The threat of heavy-handed cost based regulation still applies if access is denied or it becomes apparent that market power is being abused under the PC's price monitoring model. Hence, if a pipeline owner abuses price monitoring under the PC's model, then it risks being 'covered' and regulated under heavy-handed cost based regulation.<sup>2</sup>

2.6 A criticism of the PC's price monitoring approach is that it does not meet the minimum requirements necessary to be 'certified' as an effective regime under Part III A of the Trade Practices Act 1974.<sup>3</sup>

TRUenergy disagrees with this. In fact, the PC considers this issue and makes statements to the contrary in its review of the Gas Access Regime. The PC considers it likely that the Minister and the NCC would be able to certify the new access regime as 'effective'. However, it acknowledges that there might be some uncertainty on this issue until the Minister and the NCC formally consider certification of the new regime.<sup>4</sup> In fact, the PC recommends Clause 6 of the Competition Principles Agreement be modified<sup>5</sup> as recommended by the PC in its review of the National Gas Access Regime which adequately deals with this uncertainty.

2.7 Another criticism of the PC model of price monitoring in the MCE consultation paper is that the 'coverage' test as modified should only identify pipelines that have substantial market power. It is questionable whether it is appropriate to have a truly light handed regulatory model as the default regulatory regime in such situations.<sup>6</sup>

TRUenergy believes that this statement is inaccurate and misleading. The PC's model of price monitoring applies regulation where a pipeline satisfies the 'coverage' test under Section 1.9 of the Gas Code. If

a) It passes the 'coverage' test then it will be regulated.

b) It will then be subject to the PC's price monitoring approach<sup>7</sup> which represents an appropriate level and form of regulation at this stage of proceedings..

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<sup>2</sup> PC Review of the Gas Access Regime p.346 "

As noted, the Commission recommended maintaining the current regulatory approach (access arrangements with reference tariffs) for cases where the Minister judges its application to be warranted. Such cases could include those where the misuse of market power becomes evident after a period of light-handed regulation. That is, the abovementioned credible threat against the misuse of market power could be the prospect of being required to have an access arrangement with reference tariffs. "

<sup>3</sup> MCE Consultation on the MCE Response to the review of the National Gas Access Regime p. 11

" Moreover, modification to the Commission's proposals still may be required to produce an effective access regime. As a result, it is questionable whether the default regulatory regime that has been proposed would provide a truly 'light handed' alternative to the current regulatory regime. "

<sup>4</sup> PC Review of the Gas Access Regime - p.388

" The Commission considers it likely that the Minister and the NCC would be able to certify the new regime as effective. However, the situation will remain uncertain until the Minister and the NCC formally consider certification of the new regime.

<sup>5</sup> PC Review of the Gas Access Regime - p.388 Recommendation 8.13 " 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.

<sup>6</sup> MCE Consultation on the MCE Response to the review of the National Gas Access Regime p. 11

" Secondly, notwithstanding the formal requirements of Part IIIA, the coverage test as modified should only identify pipelines that have substantial market power, and it is questionable whether it is appropriate to apply a truly light-handed model as the default regulatory regime in such situations. A number of jurisdictions have undertaken substantial reforms to their gas industries on the assumption that effective regulation of the residual monopoly components of the industry would continue.

<sup>7</sup> The PC's price monitoring approach represents an appropriate substitute to cost based regulation for pipelines that pass the 'coverage' test at this stage of proceedings. It requires pipeline owners to

- Provide the regulator with an access policy
- Comply with anti competitive conduct provisions
- Comply with the ring fencing requirements in the Gas Code
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c) If there is a 'net benefit' in applying heavy-handed cost based regulation (the pipeline exhibits substantial market power) only then will heavy handed cost based regulation be applied. The PC is aware of the detrimental impact on investment heavy handed cost based regulation brings. Hence, it attempts to implement a light-handed regime where it can.

In short, the PC model has been carefully designed to make sure that the appropriate level and form of regulation is applied to a pipeline under varying circumstances. Hence,

- (i) A transmission pipeline that exhibits monopoly characteristics will be subject to the PC' price monitoring approach.
- (ii) If a transmission pipeline subject to price monitoring has some form of market power and abuses it, it will be quickly subject to a 'coverage' application by users.

2.8 A remaining criticism of the PC model of price monitoring is it creates unnecessary uncertainty because of the form of regulation that applies with 'coverage' that complicates the assessment of the pipelines that should be 'covered'.<sup>8</sup>

TRU energy is not convinced that the PC model complicates the assessment of pipelines, but in our opinion its price-monitoring model is unambiguous and clear. It does not complicate the assessment of which pipelines should be 'covered'. It applies the simple methodology described above in Sect. 2.7 above.

### **3. The alternative price-monitoring model**

The MCE's consultation paper considers an alternative to the price-monitoring proposal developed by the PC. The model has been jointly developed by NERA and the Allens consulting group and is based on the model of regulation applied to airports in Australia.

3.1 TRUenergy is concerned that the alternative model has been recommended without an extensive consultation period to assess its appropriateness for gas.

- (i) It has not been subject to the scrutiny of the of the PC model
- (ii) The implications of applying it to gas are unclear given the lack of consultation with industry.
- (iii) The assertion that because this price-monitoring model is applied to airports makes it appropriate in gas is too simplistic..

3.2 TRUenergy is concerned the alternative price monitoring model proposed in the MCE paper may not constitute an 'effective ' access regime. It remains concerned that

- (i) An alternative price-monitoring regime has been recommended without considering whether that access regime is an 'effective' access regime. The PC has given reasonable consideration to this issue in its price monitoring approach.
- (ii) Because the alternative price monitoring regime is an 'effective ' access regime as applied to airports, does not mean that this conclusion can be drawn if that regime is applied to gas.

3.3 An alternative model is to adopt a price-monitoring regime for pipelines that have some market power, albeit not necessarily sufficient to pass the new test for 'coverage' under the regime.<sup>9</sup> However, TRUenergy believes that if a pipeline fails the 'coverage' test under Section 1.9 of the Gas Code then it should not be regulated at all.. If there is no rationale for 'covering' the pipeline under the Gas Code (the pipeline in question fails the 'coverage' tests), then regulation should not be applied.<sup>10</sup>

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<sup>8</sup> MCE Consultation on the MCE Response to the review of the National Gas Access Regime p. 12

" Thirdly, the coverage test contained in the Code operates by comparing the prospects for competition 'with coverage' against the prospects for competition 'without coverage'. The uncertainty introduced into the form of regulation that applies 'with coverage' would complicate substantially the assessment of which pipelines should be covered.

<sup>9</sup> MCE Consultation on the MCE Response to the review of the National Gas Access Regime p. 12.

<sup>10</sup> See Above

3.4 Another argument for adopting the alternative price-monitoring model is that a more light-handed regime should apply, but with wider application than that envisaged by the Commission. However, TRUenergy believes extending the hand of regulation to pipelines that fail the 'coverage' tests in the Gas Code is contrary to the findings of the PC.

#### **4.0 Greenfield Projects**

TRUenergy is concerned price regulation applied to Greenfield projects will impact the attractiveness of these investments and stymie investment. The impact on investment, the cost of compliance with regulation, and the reality that regulation complicates the negotiation of foundation shipping contracts remain strong reasons for not regulating these pipelines.

TRUenergy agrees that

- (i) The potential for asymmetric truncation creates a disincentive for pipeline investors when they are regulated under CPI-X regulation
- (ii) Five year regulatory re-sets that change pipeline owners cost of capital (WACC) every five years gives pipeline owners difficulty in forecasting their revenues..

TRUenergy recommends either of the following options including

- (i) The PC recommendation that pipeline investors be permitted to seek an up-front binding ruling of whether a pipeline would pass the 'coverage' test prior to construction.
- (ii) Fifteen year 'access holidays' for all new Greenfield transmission pipelines

#### **5.0 Conclusion**

So, in summary, the key reasons why TRUenergy supports

- The PC model of price monitoring for transmission pipelines.
- The PC's model of promoting an up-front binding ruling of whether a proposed pipeline would pass the 'coverage' test.
- The concept of 15-year access holidays for Greenfield gas transmission pipelines.

is because

- The PC' price monitoring approach represents a superior approach to the alternative model because it has been carefully developed to apply the right level and form of regulation under different market circumstances. It is designed with appropriate checks and balances, That is,
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  - The PC's price monitoring approach has been developed after an extensive consultation process with industry, government, regulators and key stakeholders that formed part of the extensive process. As such, the PC has applied a thorough analysis before the model was recommended. The alternative model has not had the same level of rigour applied to it before being recommended for gas.
  - The PC's price monitoring approach in conjunction with minor changes to the Competition Principles Agreement would constitute an "effective access regime" according to the PC..
  - The PC's model of promoting an up-front binding ruling of whether a proposed pipeline would pass the 'coverage ' test provides protection for investors from the in-efficiencies of regulating these pipelines. Fifteen-year access holidays provide the same outcome. As such, TRUenergy supports both these policy positions.

Regards

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