

MCE Consultation Paper

Review of the National Gas Pipelines Access Regime

AGL's detailed response

Overview

AGL's analysis of the consultation paper is that it responds only superficially to the PC review and effectively re-opens matters that were considered comprehensively in the PC review. In doing so, it misses an opportunity to make a useful contribution to the MCE reform program. Only 9 out of the 54 PC recommendations have been accepted. It is proposed that most of the other recommendations should be deferred to a further, separate and unnecessary review. Neither the process nor timetable for such review is defined. On the few occasions where the paper does propose alternatives, these alternatives effectively reverse the direction of the PC review, and would result in more rather than less regulation.

There is no need to re-open the PC's review. There has been extensive consideration of the issue of the appropriate approach to economic regulation by the PC through its reviews of the National Access Regime and the Gas Access Regime. While the PC review does not reflect AGL's position on a number of elements, AGL believes that the review is soundly based on the Government's response to the National Access Regime and that it reaches a level of balance that improves the Gas Access Regime.

The recommendations made in PC Review of the Gas Access Regime incorporated the Governments' agreed response to the National Access Regime. To re-open the review is likely to create greater uncertainty and will not deliver on the objectives of the energy reform program.

Flaws in underlying assumptions in the consultation paper

The approach taken in the consultation paper rests on the premise that a response in the specific context of the Gas Access Regime needs to be integrated with the broader reforms being undertaken in the energy sector. It is asserted that:

- Integration would require a number of the PC's recommendations to be extended or modified, and for consideration of some of the recommendations to be deferred to future, energy wide review processes;
- The PC's review comprised only a subset of the reforms being suggested for the gas sector.
- A number of recommendations must be deferred until they can be considered together with electricity or that a clean slate approach is required (such as on pricing matters).

AGL agrees that it is important to ensure that the MCE response in the specific context of the Gas Access Regime is integrated with the broader reforms being undertaken in the energy sector. However, AGL believes that this means that the Gas Access Regime, amended in line with the PC recommendations, should be used as the basis. The PC's review builds on a nationally applied access regime and recommends significant improvements to it, thereby delivering best practice regulation for gas. The benefits of this review are most efficiently captured by implementation of the PC's recommendations now, rather than waiting for a further and extensive consultation process to cover all energy infrastructure. Deferring matters is both unnecessary and inefficient, and likely to result in greater uncertainty, rather than less.

The consultation paper simply asserts that a "clean slate" approach is required, claiming that such an approach would be expected. However, no rationale for such an expectation is provided and there is a worrying lack of recognition of the policy direction set by previous reviews and Government responses, particularly in relation to

the National Access Regime. The recent review of the Gas Access Regime sought to align the Gas Access Regime with the reforms that had been agreed by Governments to the National Access Regime. Accordingly, AGL believes that there are compelling policy reasons for using the Gas Access Regime as the basis for the broader reforms.

While AGL accepts that there are matters that would apply equally to electricity, AGL does not accept that the most appropriate approach is to defer consideration of these matters and consider them jointly. For example, the idea of a single process for determining pricing arrangements for all energy infrastructure under a single review may have superficial appeal. However, such an approach is problematic because the significant areas of difference between gas, electricity transmission and electricity distribution will make such a review complex compared to consideration of each infrastructure group separately.

It makes more sense to apply the gas model as it stands as the national approach now rather than developing "clean slates" for both the framework and rules. The Gas Regime is a certified effective regime due to both its content and adoption as a state-based regime, while the electricity regime does not have these advantages. Any new "clean slate" regime may need to be tested for effectiveness, creating additional uncertainty and delay. That is, failure to implement the package of recommendations from the PC will result in greater uncertainty rather than less and therefore will not meet the objectives set by CoAG for the MCE¹.

Way forward

A more efficient approach would be to apply the PC's recommendations for gas and then undertake reviews for electricity transmission and distribution, which can then utilise the aspects of gas, that are relevant to them in a targeted way. It should be noted a separate review for electricity transmission (Chapter 6 of the NER) is already under way by the AEMC. It would be sensible and efficient to delay major consideration of pricing matters for the Chapter 6 review until the revisions to the Gas Access Regime are implemented.

Accordingly, AGL suggests that the following steps should be followed for the MCE to finalise a response to the PC's Review:

- The PC's recommendations should be adopted except where the MCE has clear objections, in which case it should set them out and offer clear alternatives for consultation.
- Where an element of the PC's recommendations has not been fully detailed (eg the monitoring regime) a joint government and industry working group should be tasked with developing the detail necessary for implementation; and
- Following implementation of changes to the Gas Access Regime, the MCE should undertake similar reviews for electricity distribution and for electricity transmission (including revenue and pricing matters which should be deferred from the AEMC review of chapter 6 of the National Electricity Rules).

Set out below are AGL's detailed comments on each of the areas covered by the consultation paper.

High Level Guidance - Insertion of an Objects Clause

AGL welcomes the endorsement in the consultation paper of the PC's recommendation for an over-arching objects clause and the recognition that the inclusion of an overarching objects clause is highly desirable to clarify the policy intent of the regime, guide and improve the accountability of all decision makers, provide greater certainty to service providers and access seekers about possible regulatory intervention; and promote regulatory consistency.

¹ Australian Energy Market Agreement

AGL is pleased that the consultation paper considers the overall objects clause proposed by the PC in its reviews of the National Access Regime and the Gas Access Regime. AGL believes that this formulation is preferable as it is consistent with the approach taken by Governments in the review of the National Access Regime.

AGL acknowledges that the objective in the National Electricity Law is expressed differently. However, AGL also notes that the National Electricity Law is largely concerned with the electricity market and covers a greater range of market activities not associated with access to electricity infrastructure.

Further, in its submission in December 2004 on the National Electricity Law AGL expressed concerns with the National Electricity Law objective. In particular, AGL noted that considerable work has been undertaken on appropriate objectives clauses by the Productivity Commission in the review of the National Access Regime and the review of the Gas Access Regime and that the new market objective did not appear to take this work into account fully.

AGL also noted that the objective could be interpreted broadly or with an economic focus. Given the intention that the NEM is to be an economically efficient market and that other policy matters are to be dealt with elsewhere, AGL had previously indicated that it was essential that the MCE clarify that the objective be interpreted in an economic sense. The clarification was provided by relevant comment in the second reading speech.

AGL submits that the PC's proposed objective is more appropriate because:

- it is clear and unambiguous;
- it is designed to cover access regulation for infrastructure; and
- it provides clear and strong alignment with the National Access Regime.

AGL is pleased that it has been agreed to delete the preamble to the Gas Pipelines Access Law, but is concerned that rather than accepting the PC's recommendations, it is proposed to consider these recommendations further in the context of developing the common legal framework for the gas and electricity access regimes. As set out above, AGL believes that the most appropriate approach is for the rules in an amended gas access regime to comprise the starting point for consideration of a consistent set of energy access rules. The PC's rationale for removing these provisions is sound and the consultation paper provided no reason for not accepting the recommendation.

Coverage test

AGL welcomes the recommendation in the consultation paper to revise the coverage test in the manner suggested by the PC in its review of the Gas Access Regime and to agree to the PC's recommendation to ensure the scope for forum shopping be removed and consistency with the National Access Regime.

Form of Regulation - Monitoring

The consultation paper proposes its own alternative to the PC's proposal for light handed regulation through a monitoring regime for pipelines that meet the coverage test (ie. they have material market power), but do not have substantial market power. The alternative proposal is to effectively extend regulation through a price monitoring regime for pipelines that do not meet the coverage criteria; that is to regulate pipelines that have little or no market power.

There is no need for this alternative proposal because the underlying assumptions are flawed:

- Contrary to the assertion in the consultation paper, there is no sound basis for suggesting the PC's proposal would not meet the effectiveness test in the

Competition Principles Agreement (CPA)². Binding arbitration was included as part of the monitoring regime in PC's Final Report to remove any doubt about this matter. Even without the inclusion of a binding arbitration requirement, it is likely that the Gas Access Regime would continue to be effective in terms of the CPA. This is because the existence of binding arbitration for covered pipelines under the "heavy handed" access arrangement regulation meets the requirements of the CPA and, under the monitoring regime, there is a continuing threat of moving to the "heavy handed" regime (for which arbitration is required) if there is an exercise of any residual market power.

- The paper is incorrect in a number of other aspects regarding the coverage test.
 - The coverage test identifies pipelines with "material" market power not "substantial" market power.
 - The consultation paper discusses a "default regulatory regime". It is not clear what this means, however the PC does not envisage a "default regulatory regime". Rather a positive decision is required. If it is describing the alternative "price monitoring regime" then it is effectively questioning the appropriateness of its own alternative approach.
 - The paper is right about it being "questionable whether is appropriate to apply a truly light-handed model as the default regulatory regime in such situations"; however, this is what the Consultation Paper proposes. The introduction of an additional layer of regulation for pipelines that have less than a "material" level of market power as proposed in the Consultation Paper should be seriously questioned and is contrary to the both the National Access Regime and the CPA. The PC, in contrast to the paper's proposed alternative, has recommended that where market power is at least "material", some form of regulation is required, and that where it is not significantly greater than "material" market power a light handed approach (ie a monitoring regime) is appropriate.

It is incorrect to assert that the introduction of the PC's monitoring regime will create uncertainty. This view appears to derive from an expectation that the Coverage Test will be applied in such a way as to only compare 'without coverage' to 'with coverage and monitoring only'. In fact, as the coverage body will have control over whether to apply 'light handed' (ie monitoring) or 'heavy handed' regulation (access arrangement) it will be well placed to determine which regulatory approach it is considering in the 'with coverage' versus 'without coverage'. Furthermore, if there were any increased uncertainty it would be no more than that created by having a new layer of regulation under the proposed alternative price monitoring regime proposed in the consultation paper, where there would be a reduced difference in the level of market power.

The characterisation of the proposed alternative as a 'true' price monitoring regime is an assertion which is not supported. More importantly, while superficially appealing there is no sound basis for suggesting that a 'covered and monitored' pipeline will have any more difficulty achieving revocation of coverage (under the PC's recommendation) than a pipeline that has 'heavy handed' regulation obtaining revocation (under the consultation paper's alternative)

In summary, the alternative proposal for increased regulation rather than reduced – which is the effect of the PC's monitoring proposal – is both contrary to the PC's overall recommendations on regulation and rather than simplifying the matter adds to uncertainty and confusion.

It is clear that the PC's recommendation for monitoring provides solid principles to work from, but also needs to be "fleshed out" and clarified. AGL proposes that the MCE should accept the PC's proposed approach to the monitoring regime and fill it out and clarify it for implementation through a focussed joint government and industry working group.

² Consultation Paper, Page 11, 1st bullet

Promoting greenfields projects

The consultation paper proposes implementing a price regulation "holiday" for greenfields pipelines for 15 years as an alternative to the PC's recommendation of a 15 year binding non-coverage ruling.

While AGL acknowledges that the PC's recommendation raises some practical issues we believe it to represent an enhancement to the Gas Access Regime. AGL recognises the intent behind the proposed alternative, but does not believe that it is sufficiently different from the PC recommendation to give confidence that it would solve those practical issues.

The option of a 15 year period of no regulation for greenfields pipelines would represent a significantly different alternative only if (as seems to be assumed in the consultation paper) the "essential characteristics of greenfields projects" were self-evident and undisputable. AGL believes that this is not the case and that, in reality, this option may simply substitute an alternative but equally uncertain process to gain accreditation as a greenfields project. This concern is noted in the consultation paper when it says that³ "... the challenge with implementing an exemption for greenfields pipelines is to develop a definition or process for identifying pipelines ...".

In addition to these issues AGL notes that a key MCE objective is⁴ "... regulatory reform to facilitate the delivery of gas supplies into the south east market from the west and/or north of Australia ...". The practical issues with the PC's recommendation are particularly problematical for major, complex pipeline developments such as these. The PNG to Queensland pipeline is an immediate example of such a project and AGL's current experience as a proponent of that pipeline is that the regulatory certainty required by investors would not be met within the required project timeframe, either by the PC's recommendation or by the consultation paper proposal.

Overall AGL considers that the consultation paper proposal will need to be refined in order to overcome the issues identified with the PC's recommendation. AGL suggests that a refined proposal is necessary in addition to the binding no-coverage period recommended by the PC.

Administration of the Coverage Test

AGL supports the broader theme of the energy market reform program which is to create a greater separation between rule making and rule application and enforcement. Accordingly, AGL welcomes the proposal to accept the PC recommendation to retain the existing principle of separating coverage assessment and regulation.

However, no rationale has been put forward to explain any issues or difficulties with the PC recommendation that the NCC should make recommendations regarding coverage. Importantly, the consultation paper does not consider two important matters that indicate that the continuation of the NCC is clearly the best policy option:

- The NCC is the recommending body for declaration under Part IIIA of the Trade Practices Act. Coverage under the Gas Code is the analogue of declaration and the tests employed for coverage and declaration are essentially the same and have similar purpose; and
- The AEMC's role is that of rule maker for regulation and operation of markets. Coverage decisions are distinctly different and it is appropriate that consideration of coverage matters be kept with the body that maintains relevant expertise.

In addition, if the AEMC were to make decisions about coverage, this would mean that the principle regarding separation was not upheld.

³ Consultation Paper, page 15-16

⁴ Supplement to MCE report to CoAG, May 2004

Specific guidance on Pricing matters and Regulatory Processes

The consultation paper purports to provide a rationale for its recommendation to effectively set aside the PC's recommendations (PC recommendations 7.1-7.8, 7.10-7.11, 11.1 – 11.3) on pricing related matters and replace them with a separate process for developing a consistent set of rules for electricity and gas transmission and distribution. Those sections of the consultation paper contain flaws in either the underlying premise or reasoning as follows:

- It is incorrect to suggest that PC's recommendation to replace the pricing principles in section 8.1 of the Gas Code did not significantly simplify the Code. The PC recommended that the six complex, uncertain and competing pricing objectives in the Code be replaced by a simple three part set of principles which are clear, unambiguous and do not compete. Moreover the PC's recommended principles replicate those agreed to by the Governments for the National Access Regime and consistency with Part IIIA of the TPA is essential to maintaining the integrity of National Access Regime. The Consultation Paper has not explained why the pricing principles that have been agreed to be the basis for consistency of access regulation nationally should not be applied for the Gas Access Regime.
- While there is divergence on guidance on pricing between gas and electricity in the Gas Code and the National Electricity Rules, it is incorrect to suggest that the Gas Code is complex, especially once the PC's recommendations are applied⁵. The guidance in the Gas Code as proposed by the PC provides the clear and simple mechanisms for deriving cost of service based pricing for gas. To the extent that there is uncertainty in the Gas Code's guidance the PC's recommendations have substantially dealt with this issue.
- The policy goal of having consistency in the approach to economic regulation is appropriate⁶. However the assumption in the consultation paper of the "expectation" that a clean slate is optimal or useful is flawed. While there are a number of similarities between gas and electricity, and transmission and distribution from a high level economic perspective, because of the long life of assets, natural monopoly characteristics and the linear/network nature of the infrastructure, there are also significant economic and technical differences at a lower level. Consequently, the option of embarking on a fresh approach to pricing which considers all energy infrastructure is unnecessary, inefficient and problematic.
- The idea of a single process for determining pricing arrangements for all energy infrastructure under a single review may have superficial appeal. However, such an approach is problematic because the significant areas of difference between gas and electricity distribution and transmission will make such a review complex and protracted compared to separate consideration of each infrastructure group.

Specific Guidance

On the matter of specific guidance on pricing the consultation paper⁷ proposes guiding rules for assessment of regulated prices to provide an appropriate degree of certainty of owners as to the outcomes of price regulation and adopt best-regulatory practice⁸.

AGL agrees that certainty is the appropriate policy goal, but the PC made specific recommendations on the issue of guidance and the consultation paper does not explain why the PC's recommendations are inadequate. The examples given in the consultation do not progress the debate:

⁵ In particular, Recommendations 5.3 – 5.6 and 7.1 – 7.15

⁶ However, this is not the same thing as the "national approach to energy access", which is concerned with applying a single route within Part IIIA of the TPA. The approach of using the certified effective regime route has now been agreed.

⁷ SCO Consultation Paper, page 17, 18

⁸ SCO Consultation Paper page 18, 1st box

- Incentives related to reliability may be relevant to electricity, but are not to gas, because of the inherent reliability of gas; and
- The needs for a regulatory test for electricity transmission is understood, but is not relevant for gas. Consideration of such matters would not only be redundant but add complexity.

Process

The SCO Paper identifies a number of process issues⁹ to be included in rules and suggests that the Gas Code process is complex. These comments appear to reflect a lack of understanding of the Gas Code. The Code already provides for all of the matters being suggested as required as a minimum in the Consultation Paper, which incorrectly suggests that the process is particularly complex. The Code process reflects the processes almost universally adopted by regulators across Australia. The PC has moved to further simplify them by removal of one step (The Further Final Decision). The proposal by the Consultation paper adds nothing to the Gas Code as amended in line with the PC's recommendations.

Information gathering, Regulatory Discretion, Appeals and Other Regulatory Matters

The Consultation Paper proposes that Code provisions related to the regulator's powers to gather information, the level of its discretion, arrangements for appeals of a regulator's decision and matters related to Associate Contracts also be deferred to a separate process related to establishing common approaches for gas and electricity. However, the assumptions underpinning the belief that there is a need to open up a new process are flawed.

Information gathering

The rationale for opening up the matter of information gathering powers appears to be based solely on the goal of achieving a common approach to this matter in gas and electricity¹⁰.

The consultation paper identifies that there are more extensive powers in relation to electricity than gas. However, it fails to note that the Gas Code powers are applied nationally and that the PC recommends a reduction rather than an increase in information gathering powers. It also does not acknowledge the fact that the information gathering powers under the Gas Access Regime are extensive, with Section 41 of the Gas Pipelines Access Law (GPAL) enabling the regulator to gather information from any party that it thinks may hold relevant information. It also has powers to require Service Providers under the Code to have guidelines for regulatory accounts to be approved in order for the regulator to base its regulatory reviews an appropriate set of regulatory accounts. The suggestions in the consultation paper that the Gas Access Regime information gathering powers are "poorly defined or incomplete" are simply not correct.

The main difference between gas and electricity seems to be powers related to requiring annual provision of regulatory accounts and for the regulator to determine how cost allocations should be made in regulatory accounts. The PC specifically recommends against this approach. However, the consultation paper makes no reference to the PC's recommendations that should lead to improved clarity about information provision or to the PC's findings that no extension of those powers¹¹ is warranted.

In summary, the case proposed for reopening this issue is superficial. Moreover, it does not identify the potential for the approach to information gathering powers in the Gas Access Regime to be a sound reference point for those in electricity. Consistent with the other significant matters in the Consultation Paper the approach of reopening

⁹ SCO Consultation Paper, page 18

¹⁰ SCO Consultation Paper, page 19, 3rd bullet point

¹¹ Such as yearly provision of regulatory accounts or prescriptions about cost allocations

consideration on information gathering powers does not have a sound basis, which is in contrast to the PC's recommendations.

Regulatory Discretion

The consultation paper seeks to explain why the issue of regulatory discretion contained in the Gas Access Regime and affirmed by the PC, should be reopened¹². However, the rationale for this does not stand scrutiny. The consultation paper suggests that the Code approach to regulatory discretion "may imply more disputes and costs in the future and may counteract the degree of uncertainty over outcomes of future regulatory decisions".

The Gas Code requires that the regulator must adopt a different level of costs when the Service Provider's proposed costs are outside a plausible range, but must accept them if they are not. It is hard to see how such an approach can be more likely to create disputes and uncertainty than one where the regulator makes its own decisions on matters that are not precisely known. Clearly where a service provider submits costs based on a plausible range it will have a greater degree of confidence that its costs will be accepted by the regulator. Further, where the regulator has determined its view of the plausible range, and does so based on information provided by the service provider, the basis of any decision not to accept them will be transparent and more likely to be accepted by the service provider and participants. The result therefore is to reduce disputes. Further, actual practice under the Code since the GasNet case¹³ indicates that disputes will be reduced.

Again, the consultation paper does not provide a sound basis for reopening the Gas Code and ignoring the PC recommendations, particularly contrasted to the PC's extensive consideration of the matter. Moreover, the Gas Code (as amended in line with the PC's recommendation) provides an opportunity for streamlining and reducing the cost of energy access regulation.

Appeals

AGL is aware that the MCE has agreed the issue of merits review should be considered as a separate stream in the context of the Energy Market MCE reform program. However, AGL believes that the PC's recommendations in its review of the Gas Access Regime were adequate and should be used as the basis for merits review across the energy sector.

Associate Contract Matters

The consultation paper's only basis for not accepting the PC's recommendation on the matters of Associate Contracts is to provide common legal provisions for gas and electricity. Such a reopening is not necessary or beneficial. The PC's recommendations provide simplification and clarification to the Gas Code on matters that should be uncontentious. It is difficult to see why the consultation paper recommends a reopening of matters for which there is likely to be no benefit. Rather than reopen this question the PC's recommendation should be applied. To the extent that these matters are applicable to electricity, they provide a useful basis for a review of electricity access regulation to deliver consistency.

¹² SCO Consultation Paper, Pages 19, 20

¹³ Review of the Further Final Decision on GasNet's Access Arrangement 2002 – Application by GasNet (Operations) Pty Ltd [2003] ACompT 6