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26 March 2018

Mr John Pierce  
Chair  
Australian Energy Market Commission  
PO Box A2449  
SYDNEY SOUTH NSW 1235

~~Dear Mr Pierce~~

**Re: ACCC submission on AEMC Review into the scope of economic regulation applied to covered pipelines draft report**

The Australian Competition and Consumer Commission (ACCC) appreciates the opportunity to comment on the Review into the scope of economic regulation applied to covered pipelines draft report (the Draft Report).

The ACCC considers that the key issue of the review is how to amend Parts 8-12 of the National Gas Rules (NGR) to address concerns that pipelines subject to full regulation are able to exercise market power to the detriment of economic efficiency and the long term interests of consumers. The Australian Energy Market Commission's review provides an excellent opportunity for the AEMC to address these issues and promote more economically efficient outcomes.

The ACCC welcomes the recommendations to improve the process for determining reference services and require that expansions to covered pipelines become part of the covered pipeline. The ACCC agrees that the information disclosure and arbitration for covered pipelines should be improved. However, rather than aligning some aspects of light regulation with Part 23 of the NGR, the ACCC recommends removing light regulation, and subjecting those pipelines to Part 23.

Attached is the ACCC's submission to the Draft Report outlining our recommendations in more detail. The ACCC looks forward to assisting the AEMC in further developing these proposals in any way the AEMC considers useful.

Yours sincerely

Rod Sims  
Chairman



Australian  
Competition &  
Consumer  
Commission

# ACCC submission on Review into the scope of economic regulation applied to covered pipelines Draft Report

March 2018

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# 1. Executive Summary

The ACCC welcomes the Australian Energy Market Commission's (AEMC's) review into the scope of economic regulation applied to covered pipelines outlined in its February 2018 Draft Report.

The ACCC, in its 2015–2016 inquiry into the competitiveness of the wholesale gas inquiry on the East Coast of Australia, found that monopoly pricing by pipeline operators was having a detrimental effect on gas supply and pricing in the domestic market. The ACCC recommended that the COAG Energy Council ask the AEMC to review the economic regulation of covered (that is regulated) pipelines, which has led to the AEMC's current review.

From its review, the ACCC identified the following issues: monopoly pricing by pipeline operators, regulatory gaps that may allow pipeline operators to charge monopoly prices, information asymmetries, and issues with the existing arbitration framework. This AEMC review provides an excellent opportunity for the AEMC to address these issues and promote more economically efficient outcomes on regulated pipelines.

The ACCC supports the AEMC's recommendations to improve the operation of Parts 8-12 of the National Gas Rules (NGR). Specifically, the ACCC supports:

1. The improvements to the definition of reference services for full regulation pipelines, including the upfront process to determine what services should be reference services;
2. The inclusion of all expansions to covered pipelines as part of the covered pipeline; and
3. The amendments to give the regulator full discretion in requiring an access arrangement that best supports the National Gas Objective.

The ACCC agrees with AEMC that the current coverage test and form of regulation test are no longer appropriate and should be re-examined. As these are complex and important issues, we consider that it would be more appropriate to address them as part of the review of the operation of the new information disclosure and arbitration regime set out in Part 23 of the NGR in 2019.

The ACCC also supports the intent of the AEMC in aligning light regulation with the new regime in Part 23 of the NGR. However, given the similarities between the regimes the ACCC strongly holds the view that it would be more appropriate to remove light regulation and make amendments to Part 23. The ACCC considers that retaining and significantly amending light regulation would create an unnecessarily complex regulatory framework (with the associated increased regulatory costs) that does appear to provide sufficient benefit to justify that complexity.

## 2. Background

In 2015, the Minister for Small Business directed the ACCC to hold an inquiry into the competitiveness of the wholesale gas industry on the East Coast of Australia (the First Inquiry).<sup>1</sup> The First Inquiry found that pipeline operators are using market power to obtain above-efficient prices, and this monopoly pricing behaviour is affecting the achievement of economically efficient outcomes.<sup>2</sup> It identified a number of gaps in the regulatory framework that allowed covered pipelines subject to full regulation to engage in monopoly pricing. The First Inquiry also found that the coverage criteria used to determine if a pipeline should be regulated are not designed to address the market failure that was observed.<sup>3</sup>

The First Inquiry recommended the COAG Energy Council ask the Australian Energy Market Commission (AEMC) to review Parts 8-12 of the National Gas Rules (NGR) and to make any amendments that may be required to address the gaps identified by the Inquiry and the concern that pipelines subject to full regulation are able to exercise market power to the detriment of consumers and economic efficiency. The First Inquiry suggested that the AEMC consider if any changes to the dispute resolution mechanism in the NGL and the NGR were necessary to make it more accessible to shippers, and therefore provide a more effective constraint on the behaviour of pipeline operators.

The First Inquiry also recommended that the AEMC consider whether the information disclosure requirements in the NGL should be expanded to require all pipelines operating on an open access basis (that is, regulated and unregulated pipelines) to publish financial information that shippers can use to determine whether or not the prices they are offered by pipeline operators are cost reflective. The publication of this information would enable shippers to negotiate more effectively with pipeline operators and to identify any exercise of market power more readily.<sup>4</sup>

On 19 April 2017, the Treasurer directed the ACCC to hold an inquiry into measures to improve the transparency of gas supply arrangements in Australia; the supply and demand for gas in Australia; and the supply and demand for gas transportation services in Australia (the Second Inquiry).<sup>5</sup> As part of the Second Inquiry, the ACCC continues to monitor the behaviour of regulated and unregulated pipeline operators and its impact on the market for gas transportation services and gas prices paid by consumers (among other things).

In response to the ACCC's finding that the coverage test was not addressing the market failure observed, the COAG Energy Council in August 2016 directed Dr Michael Vertigan to conduct an 'Examination of the current test for the regulation of gas pipelines' (the Examination).<sup>6</sup>

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<sup>1</sup> ACCC, *Inquiry into the East Coast Gas Market*, April 2016.

<sup>2</sup> ACCC, *Inquiry into the East Coast Gas Market*, April 2016, chapter 6.

<sup>3</sup> ACCC, *Inquiry into the East Coast Gas Market*, April 2016, p. 134.

<sup>4</sup> ACCC, *Inquiry into the East Coast Gas Market*, April 2016, p. 12, ACCC recommendation 5.

<sup>5</sup> For the terms of reference for the Second Inquiry, see: <https://www.accc.gov.au/system/files/Gas%20market%20transparency%20measures%20Terms%20of%20reference.pdf>.

<sup>6</sup> Dr Michael Vertigan AC, *Examination of the current test for the regulation of gas pipelines*, 14 December 2016.

Consistent with the First Inquiry, Dr Vertigan found that:

- pipeline operators have market power, the exercise of which, in some instances, results in inefficient outcomes that do not promote the National Gas Objective (NGO), or facilitate the achievement of the Council's Australian Gas Market Vision; and
- the coverage test does not appear to be posing a credible threat to pipeline operators.<sup>7</sup>

To address these issues, the Examination recommended steps be taken to strengthen the negotiating position of shippers by requiring greater disclosure of information and introducing a binding commercially oriented arbitration mechanism in the National Gas Law (NGL).

In the first half of 2017, the Gas Market Reform Group (GMRG) developed and consulted on an information disclosure and arbitration framework for non-scheme pipelines to implement the recommendations of the Examination. The new framework, which is set out in Chapter 6A of the NGL and Part 23 of NGR requires pipeline operators to disclose certain information about pipeline services costs, pricing and contract terms. It also requires pipeline operators to comply with a number of rules that are designed to facilitate timely and effective negotiations and provides for a binding commercial arbitration framework that parties can have recourse to if they are unable to reach agreement on pipeline access.<sup>8</sup> This new framework came into effect on 1 August 2017.<sup>9</sup>

In May 2017, the COAG Energy Council tasked the AEMC with reviewing Parts 8-12 of the NGR in line with the ACCC's recommendation from the First Inquiry.<sup>10</sup> The AEMC released an issues paper in June 2017 and an interim report in October 2017.<sup>11</sup> In February 2017, the AEMC released its draft report and recommendations.<sup>12</sup>

The ACCC's submission to the Draft Report focuses on the issues outlined in the ACCC's First Inquiry, that is, issues with reference services, coverage of expansions, and the framework for regulation.

### 3. Reference services

As noted by the AEMC, the policy intent of 'reference services' is to act as a constraint on the market power of the service provider in the provision of pipeline services. When a prospective user seeks the reference service, it acts as a direct constraint on the service provider's market power by setting an ex ante price for that service and other terms and conditions of access. When a prospective user seeks another pipeline service, the reference service can act as an aide to negotiation by narrowing the points of contention.<sup>13</sup>

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<sup>7</sup> Dr Michael Vertigan AC, *Examination of the current test for the regulation of gas pipelines*, 14 December 2016, pp. 9-10, 12-13.

<sup>8</sup> Gas Market Reform Group, *Gas Pipeline Information Disclosure and Arbitration Framework: Initial National Gas Rules: Explanatory Note*, 2 August 2017.

<sup>9</sup> See the AEMC website for rules: [http://www.aemc.gov.au/Energy-Rules/National-gas-rules/Rules-made-by-SA-minister/National-Gas-\(Pipelines-Access-Arbitration\)-Amendm.aspx](http://www.aemc.gov.au/Energy-Rules/National-gas-rules/Rules-made-by-SA-minister/National-Gas-(Pipelines-Access-Arbitration)-Amendm.aspx).

<sup>10</sup> See the AEMC website for the COAG Energy Council terms of reference: <http://www.aemc.gov.au/getattachment/bbd99022-6d33-4e4b-919b-2456eb4223a0/Terms-of-reference.aspx>.

<sup>11</sup> AEMC, *Issues Paper: Review into the scope of economic regulation applied to covered pipelines*, 27 June 2017. AEMC, *Interim Report: Review into the scope of economic regulation applied to covered pipelines*, 31 October 2017.

<sup>12</sup> AEMC, *Draft Report: Review into the scope of economic regulation applied to covered pipelines*, 27 February 2017.

<sup>13</sup> AEMC, *Draft Report: Review into the scope of economic regulation applied to covered pipelines*, 27 February 2017, pp. 62-63.

While the NGR allow an access arrangement to contain multiple reference services, only one reference service has typically been defined for transmission pipelines subject to full regulation. This limitation has, in effect, allowed transmission service providers to exercise market power when providing non-reference services because these services are not sufficiently similar for the reference service to be a useful constraint in negotiations.<sup>14</sup>

The ACCC therefore supports the AEMC's recommendations to improve the usefulness of reference services.<sup>15</sup> We support clarifying the definitions for pipeline services and reference services to improve transparency about the available pipeline services and provide better guidance about reference services.

The ACCC also supports the AEMC's recommendation to amend the test for reference services.<sup>16</sup> As we noted in our submission to the AEMC's issues paper, reference services should be developed for each type of service offered by the pipeline (e.g. forward haul (firm, as available, and interruptible), backhaul, and park and loan services).<sup>17</sup> We support a new test that takes into account the historic and forecast demand for services, the extent to which the service is substitutable with other services, and the usefulness of the service in supporting access negotiations.<sup>18</sup>

However, the ACCC does not believe that the feasibility of allocating costs to the service should be a limb of the reference service test because it could exclude services such as 'interruptible' and 'as available' services from being reference services. This is because these services are typically priced as a function of the forward haul tariff, with the discount or premium reflecting other factors, such as the opportunity cost of providing the service.

To facilitate the inclusion of more reference services, the AEMC proposes introducing an upfront reference tariff setting process to occur before the service provider submits its access arrangement.<sup>19</sup> We support the introduction of this process because it will allow prospective users, the service provider, and the regulator to consider what reference services would help users to negotiate with the service provider, therefore better constraining the exercise of monopoly power. It should also encourage pipeline operators to be more responsive to the needs of users.

In principle, the costs to be recovered from the users of reference services should exclude the costs of providing non-reference services. However, rule 93 allows the regulator to allocate the costs of providing a 'rebateable service' to the reference service if it is satisfied the service provider will later rebate a portion of the revenue from the sale of that service to the users of reference services. Rule 93(4) allows a service that is not a reference service to be defined as a rebateable service if substantial uncertainty surrounds either the extent of the demand for or of the revenue to be generated from the service, and the market for this service is substantially different from the market for reference services.

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<sup>14</sup> ACCC, *Inquiry into the East Coast Gas Market*, April 2016, pp. 134-135.

<sup>15</sup> AEMC recommendations 4 & 5.

<sup>16</sup> AEMC recommendation 6.

<sup>17</sup> ACCC, *Submission on Review into the scope of economic regulation applied to covered pipelines Issues Paper*, August 2017, p. 8.

<sup>18</sup> AEMC, *Draft Report: Review into the scope of economic regulation applied to covered pipelines*, 27 February 2017, pp. 67-69.

<sup>19</sup> AEMC recommendation 7.

The AEMC recommends removing the requirement that a rebateable service be in a different market to reference services and amending the way that the rebate occurs.<sup>20</sup> The ACCC supports these changes because as currently drafted this requirement could unnecessarily constrain the specification of rebateable services and prevent any revenue derived from the provision of these services from being shared with users that are, in effect, funding the provision of these services.

## 4. Expansions and extensions

As noted in the ACCC's submission to the issues paper, under the NGR there is discretion to exclude expansions of a full regulation pipeline from the definition of the covered pipeline. This can result in tranches of capacity on some full regulation pipelines not being subject to regulation even though there is no effective competition for the provision of the expanded capacity that would constrain the behaviour of the pipeline operator. Where the AER allows expansions to be excluded from the covered pipeline, the only remedy that users have is to apply to the National Competition Council for the expansion to be covered. The First Inquiry concluded that given these difficulties, pipeline operators may be able to engage in monopoly pricing on the expanded capacity in a relatively unconstrained manner.<sup>21</sup>

In the draft report, the AEMC concludes that if a pipeline is covered, expansions of that pipeline should be covered to prevent the exercise of market power in pricing that expansion.<sup>22</sup> As a result, the AEMC recommends that all expansions should automatically be included in the covered pipeline.<sup>23</sup> The AEMC notes that extensions to pipelines may face a different market landscape to expansions and so recommends the coverage of extensions should continue to be assessed on a case by case basis.<sup>24</sup> The ACCC supports these recommendations as they address its concerns regarding the potential exercise of market power on expansions.

Another limitation that the AEMC has identified in this context is that rule 93, which provides for allocation of 'total revenue' across reference services and other services, does not currently provide for an allocation between covered and uncovered parts of the pipeline. While this issue will be less material once the above changes regarding coverage of expansions are made, there may still be uncovered extensions of covered pipelines.

To address this the AEMC recommends amendments to the NGR to: require cost allocation in proposed operating expenditure and capital expenditure to covered and uncovered parts of the pipeline and to require the service provider to give the regulator a cost allocation methodology.<sup>25</sup> The ACCC also supports this recommendation.

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<sup>20</sup> AEMC recommendation 20.

<sup>21</sup> ACCC, *Inquiry into the East Coast Gas Market*, April 2016, p. 135.

<sup>22</sup> AEMC, *Draft Report: Review into the scope of economic regulation applied to covered pipelines*, 27 February 2017, p. 55 and AEMC recommendation 3.

<sup>23</sup> AEMC recommendations 1 and 2.

<sup>24</sup> AEMC, *Draft Report: Review into the scope of economic regulation applied to covered pipelines*, 27 February 2017, p. 55.

<sup>25</sup> AEMC recommendation 19.

## 5. Framework for regulation

With the introduction of Part 23 to the NGR, there are now essentially three forms of regulation that could apply to a pipeline: full regulation, light regulation (both under Parts 8-12 of the NGR), and the information disclosure and arbitration framework (under Part 23 of the NGR). All three forms of regulation are negotiate-arbitrate regimes.

### Coverage test and form of regulation factors

Under the current regulatory framework, a pipeline can only be subject to full or light regulation if it is a covered pipeline. A pipeline that is not already a covered pipeline (or is not subject to a 15-year no coverage determination) can become such a pipeline if it is found to satisfy the coverage test in the NGL. If the pipeline satisfies this test, it may, depending on the application of the form of regulation test set out in section 122 of the NGL, be subject to either full or light regulation.<sup>26</sup>

If the pipeline is found to not satisfy the coverage criteria, it will automatically be subject to the information disclosure and arbitration framework in Part 23 of the NGR. An exemption from Part 23 can be obtained if the pipeline does not provide third party access.

### Risk of under-regulation of pipelines

The AEMC notes that with the introduction of Part 23, the coverage test no longer determines whether regulation should or should not apply to pipelines that are providing third party access. Instead, the coverage test goes to determining which form of regulation should apply. That is, whether Part 23 should apply (uncovered pipelines) or full or light regulation should apply (covered pipelines). The AEMC concludes that the questions asked in the coverage test were designed to determine if regulation should apply, but are not the most appropriate for determining what form of regulation is applied.<sup>27</sup>

The AEMC notes that the introduction of Part 23 may inadvertently have made it more difficult to satisfy the criterion (a) of the coverage test. This is because the 'with-or-without regulation' test now will assess the relative effect on competition in related markets between regulation under Parts 8-12 (with regulation) and regulation under Part 23 (without regulation). As a result, the difference between the status quo and the counterfactual has been reduced, which the AEMC notes may lead to a reduction in the number of fully regulated pipelines.<sup>28</sup>

The AEMC notes that because Part 23 was only introduced in 2017, the materiality of this potential under-regulation may not be material. It seeks feedback on whether the issue is material and should be addressed in this review.<sup>29</sup>

Given the recent introduction of Part 23, the ACCC does not think this is a material issue at this stage. As the issue has not been fully explored with stakeholders, we caution against

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<sup>26</sup> See section 122 of NGL for the principles governing the making or revoking of light regulation determinations and section 16 of the NGL for the form of regulation factors.

<sup>27</sup> AEMC, *Draft Report: Review into the scope of economic regulation applied to covered pipelines*, 27 February 2017, p. 40.

<sup>28</sup> AEMC, *Draft Report: Review into the scope of economic regulation applied to covered pipelines*, 27 February 2017, pp. 40-41.

<sup>29</sup> AEMC, *Draft Report: Review into the scope of economic regulation applied to covered pipelines*, 27 February 2017, p. 47.

making any changes to the coverage test and form of regulation test as part of this review. Instead, as noted by the AEMC, the ACCC suggests that these two tests be reviewed as part of the review of Part 23 in 2019.

## Light regulation and Part 23

Light regulation and Part 23 are both based on the negotiate-arbitrate model and provide for the disclosure of information. While similar in concept, in practice the two regimes differ in how much information is provided to prospective users and how the arbitration mechanisms are specified.<sup>30</sup>

In the First Inquiry, the ACCC found that there is little publicly available information on the costs incurred by pipeline operators in providing services and the relationship between costs and the prices charge for services.<sup>31</sup> To remedy this we recommended that the information disclosure requirements for all pipelines (both regulated and unregulated) should be strengthened.<sup>32</sup> In addition, we were informed by market participants in the First Inquiry that the costs and resources associated with access disputes and the uncertainty of the outcome of arbitration can discourage users from triggering these provisions.<sup>33</sup> These findings led to the recommendation in our submission on the issues paper that the information provision and arbitration mechanisms on regulated pipelines (both full and light) should be aligned with those in Part 23.<sup>34</sup>

In the Draft Report, the AEMC states that given these similarities, a number of stakeholders raised the question of whether both light regulation and Part 23 were still required and whether light regulation should be removed.<sup>35</sup>

The AEMC raises three reasons to maintain light regulation. Firstly, there are advantages of having multiple forms of regulation, in that the regulation can be fine-tuned to the specific circumstances, allowing for a better trade-off between addressing market failure and the costs of regulation. The AEMC notes that multiple forms of regulation does increase complexity and regulatory burden for regulators, service providers, and users. Also, multiple forms of regulation also require a more complex test to determine which form of regulation should be applied.<sup>36</sup>

Secondly, the AEMC notes that there are some elements of the light regulation framework that are more suitable than the Part 23 framework for the certain pipelines. These provisions include some arbitration provisions, requirements not to inefficiently price discriminate, ring-fencing, and other regulatory requirements. Because of these provisions, the AEMC states that removing light regulation would be an inappropriate step as it is a useful regulatory option.<sup>37</sup>

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<sup>30</sup> AEMC, *Draft Report: Review into the scope of economic regulation applied to covered pipelines*, 27 February 2017, p. 47.

<sup>31</sup> ACCC, *Inquiry into the East Coast Gas Market*, April 2016, p. 135.

<sup>32</sup> ACCC, *Inquiry into the East Coast Gas Market*, April 2016, p. 141.

<sup>33</sup> ACCC, *Inquiry into the East Coast Gas Market*, April 2016, p. 135.

<sup>34</sup> ACCC, *Submission on Review into the scope of economic regulation applied to covered pipelines Issues Paper*, August 2017, p. 11.

<sup>35</sup> AEMC, *Draft Report: Review into the scope of economic regulation applied to covered pipelines*, 27 February 2017, p. 48.

<sup>36</sup> AEMC, *Draft Report: Review into the scope of economic regulation applied to covered pipelines*, 27 February 2017, p. 48.

<sup>37</sup> AEMC, *Draft Report: Review into the scope of economic regulation applied to covered pipelines*, 27 February 2017, pp. 48-49.

The AEMC's final reason for maintaining light regulation is that it would be complex to remove it because a process would be needed to determine what form of regulation current light regulation pipeline should be subject to. The AEMC concludes that light regulation should be maintained, but amended to more closely align some aspects with Part 23.<sup>38</sup> The AEMC states that by increasing the strength of light regulation by adding information provision requirements will help to position light regulation as an appropriate middle ground between full regulation and Part 23. The AEMC notes that this should help to address the concern that light regulation is not strong enough to address the abuse of market power by service providers.<sup>39</sup>

The ACCC agrees that light regulation and Part 23 are very similar in concept, but differ in detail. Because of this, the ACCC recommends that light regulation be removed and amendments made to Part 23 to address the areas where light regulation was seen as stronger than Part 23.

Having three forms of regulation, full regulation, light regulation, and Part 23, is complex and unnecessarily confusing for stakeholders. The proposal to amend light regulation to be more similar to Part 23 may in fact make the situation more complex. Prospective users will be faced with slightly different pipeline information and arbitration provisions between the two regimes. This has the potential to place a significant burden on smaller shippers with relatively few resources to engage in regulatory work. Service providers will also have to understand and ensure they comply with slightly different regulatory requirements, increasing their regulatory burden. If light regulation is removed, there will be two distinctly different forms of regulation – full regulation and Part 23.

The AEMC notes that there are provisions in light regulation that are preferable to Part 23, including the ability to hold joint arbitration hearings, ring-fencing requirements, and other regulatory requirements. These elements are part of the detail of the light regulation regulatory regime, not the overall structure, and so could be implemented in Part 23 if stakeholders believe that they are useful. The ACCC recommends amending Part 23 to allow for joint arbitration hearings. Other amendments to Part 23 could be made if stakeholders believe that they are necessary to strengthen Part 23 – either immediately, or following more consideration after the review of Part 23 in 2019. It is also not clear to the ACCC how significant the benefits of ring-fencing (and other provisions of light regulation) are, such that they justify tailoring regulation to specific pipelines and the complexity they necessarily would add to the regulation of pipelines.

In the AEMC's workshop for this review, one stakeholder expressed a preference for having the regulator as arbitrator because they believed this would mean a less expensive process and provide consistency across arbitration determinations.<sup>40</sup> For comparison, during Dr Vertigan's examination, stakeholders expressed little appetite for a more onerous regulatory solution, instead they wanted increased negotiating power through the credible threat of arbitration, which if initiated, would be resolved quickly.<sup>41</sup>

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<sup>38</sup> AEMC, *Draft Report: Review into the scope of economic regulation applied to covered pipelines*, 27 February 2017, p. 49.

<sup>39</sup> AEMC, *Draft Report: Review into the scope of economic regulation applied to covered pipelines*, 27 February 2017, p. 51.

<sup>40</sup> AEMC, *Draft Report: Review into the scope of economic regulation applied to covered pipelines*, 27 February 2017, p. 148.

<sup>41</sup> Dr Michael Vertigan AC, *Examination of the current test for the regulation of gas pipelines*, 14 December 2016, p. 13.

This is consistent with the ACCC's experience in arbitrating access under Part IIIA and (previously) Part XIC of the *Competition and Consumer Act*, where considerable delay in reaching a final decision imposed ongoing costs on smaller access seekers in the form of contingent liabilities in company finances and upfront costs that these access seekers had to carry for the duration of the arbitrations. It is also important to note that in Western Australia the arbitrator is not the regulator, but is instead the Energy Disputes Arbitrator for Western Australia. Given that there are divergent views on this issue, the AEMC could in due course consider changes to Part 23 that allowed a prospective user to choose whether the arbitrator should be the regulator or a commercial arbitrator. This would allow all users, not just a subset of users that are utilising light regulation pipelines, to have recourse to a regulator led arbitration.

The AEMC's third reason for maintaining light regulation is that a process would need to be devised to determine which form of regulation current light regulation pipelines should be subject to. There are currently 5.5 pipelines subject to light regulation.<sup>42</sup> With the exception of the Carpentaria Gas Pipeline that was deemed light regulation by the Queensland Government, these pipelines were subject to NCC light coverage determinations that moved them from full regulation to light regulation.

The ACCC considers there are four options for what form of regulation should apply to these 5.5 pipelines:

1. Light regulation could be retained for these pipelines only, until an application is made to the NCC for a form of regulation change,
2. The pipelines could be deemed subject to full regulation,
3. The pipelines could be deemed subject to Part 23, or
4. The NCC could be required to carry out an assessment of whether the pipelines should be subject to full regulation or Part 23 regulation.

The ACCC recommends that option 3 is the most appropriate option given that the NCC has already considered that 4.5 of the pipelines do not have the degree of market power necessary to require them to be subject to full regulation. We note that the NCC has conducted 'form of regulation' on all of the pipelines subject to light regulation, except the Carpentaria Gas Pipeline, in the last ten years.<sup>43</sup> We do not recommend option 1 because it would mean that the problems identified with the current version of light regulation will continue to affect users of these pipelines.

We acknowledge that Part 23 is new, having only been introduced in August 2017. Because of this, there may be a perception that it is untested and removing light regulation may be premature. However, it is worth noting that:

- The information disclosure requirements in Part 23 were developed through extensive stakeholder consultation over 2017 and the AEMC is proposing to adopt

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<sup>42</sup> The Envestra Gas Distribution Network (QLD), Allgas Gas Network (QLD), Carpentaria Gas Pipeline (QLD), Kalgoorlie to Kambalda Pipeline (WA), Central West Pipeline (NSW), and the Marsden to Wilton section of the Moomba to Sydney Pipeline (NSW) (the half pipeline).

<sup>43</sup> The Envestra Gas Distribution Network (QLD) (2014), Allgas Gas Network (QLD) (2015), Kalgoorlie to Kambalda Pipeline (WA) (2010), Central West Pipeline (NSW) (2009), and the Marsden to Wilton section of the Moomba to Sydney Pipeline (NSW) (2008).

similar provisions under light regulation, so this aspect of Part 23 does not appear to cause concern as being too novel.

- The arbitration mechanism in light regulation has not been used since its introduction in 2008. In the First Inquiry, the ACCC was told by market participants that the light regulation arbitration mechanism was not useful for participants because of the uncertainties around how it would operate.<sup>44</sup> In contrast, the commercial arbitration mechanism in Part 23 is based on well understood commercial arbitration frameworks that are used across a broad range of industries. The first arbitration under Part 23 began in December 2017, four months after the provisions came into effect.

While the new form of light regulation would improve the effectiveness of the threat of arbitration, we do not consider that the differences between light regulation and Part 23 confer sufficient benefits to justify two types of arbitral resolution. Accordingly, to avoid unnecessary regulatory complexity and costs associated with a new form of light regulation, the ACCC strongly recommends removing light regulation and retaining only Part 23. We recommend that the review of Part 23 in 2019 should consider whether it is appropriate to adjust it to include more 'regulatory' features in the arbitration mechanism.

## **Amendments to information disclosure and arbitration**

If the AEMC maintains its recommendation to retain light regulation, the ACCC fully supports amending the NGR to strengthen the information provision requirements and improve the arbitration mechanism that light and full regulation pipelines are subject to. In particular, the ACCC considers that the information disclosure provisions should be amended to mirror those in Part 23 of the NGR.

### **Information disclosure**

The AEMC identifies two types of information provided under Part 23: capacity and usage information and financial and offer information and considers these separately. The AEMC notes that users, consumer representatives, and the AER and the ACCC, all support greater information provision requirements for pipelines, while service providers argue that the costs may outweigh the benefits. On balance, the AEMC considers that greater information disclosure will have a greater benefit for users, than the costs that service providers may incur in providing that information.<sup>45</sup> The AEMC therefore proposes to require both full and light regulation pipelines to publish capacity and usage information.

Currently, some transmission pipelines are subject to reporting requirements on the Gas Bulletin Board.<sup>46</sup> The AEMC notes that there is significant overlap between these requirements and the information disclosure requirements under Part 23. To minimise regulatory costs, the AEMC proposes requiring that transmission pipelines should have to

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<sup>44</sup> ACCC, *Inquiry into the East Coast Gas Market*, April 2016, p. 135.

<sup>45</sup> AEMC, *Draft Report: Review into the scope of economic regulation applied to covered pipelines*, 27 February 2017, p. 128.

<sup>46</sup> Due to upcoming NGR rule changes, all transmission pipelines with a throughput of greater than 10TJ/day will be subject to the Gas Bulletin Board reporting provisions from September 2018.

disclose the same capacity and usage information that they would be required to if they were Bulletin Board pipelines.<sup>47</sup>

The capacity and usage information requirements in Part 23 for distribution pipelines are specifically tailored to distribution pipelines. Also, these pipelines are not required to report on the Gas Bulletin Board. Therefore, the AEMC recommends requiring distribution pipelines to publish the same capacity and usage information as required under Part 23.<sup>48</sup>

The ACCC supports the increased requirements for pipelines to provide service and usage information. However, the ACCC considers that the same information should be provided across all pipelines. The current recommendations mean that slightly different information will be available depending on whether a pipeline is a transmission or distribution pipeline and whether the pipeline is subject to Part 23 or not.

For example, under the AEMC's proposal a pipeline subject to light regulation would only have to publish information on the uncontract capacity for a 12 month period, whereas a pipeline subject to Part 23 is required to publish the information for a 36 month period. We understand a longer outlook period was adopted under Part 23 because shippers typically enter into gas transportation agreements for periods in excess of one year. While this is just one example of the differences between the Gas Bulletin Board reporting requirements and Part 23, it does highlight the need for the information disclosure requirements under light regulation to be aligned with the objective of facilitating timely negotiations. In our view, the part 23 information disclosure requirements are more aligned with this objective than the Gas Bulletin Board reporting requirements. We are therefore of the view that the capacity and usage information specified in Part 23 should be published by all pipelines.

Under full regulation, financial information is provided during the access arrangement process (usually every five years). The AEMC considers that this information is sufficient and does not propose any changes to the full regulation financial and offer information requirements. The AEMC recommends, however, that the financial and offer information required under Part 23 should be extended to light regulation pipelines.<sup>49</sup>

If light regulation is to be retained, the ACCC supports extending the Part 23 financial and offer information provision requirements to light regulation. We also consider that these requirements should extend to full regulation pipelines, given that users of these pipelines also have to negotiate with pipeline operators. The full regulation framework for information disclosure is set to support the 5 yearly access determination process. This information is useful for shippers seeking references services. However, where a shipper seeks a non-reference service, the shipper could benefit from the annual disclosure of financial information under Part 23. Consistent information provision across all pipelines will help users and prospective users to negotiate effectively with pipeline operators and to identify any exercise of market power more readily. Consistent information provision across pipelines will also reduce the risk that differences in reporting requirements could mislead

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<sup>47</sup> AEMC, *Draft Report: Review into the scope of economic regulation applied to covered pipelines*, 27 February 2017, pp. 128-130, AEMC recommendation 21.

<sup>48</sup> AEMC, *Draft Report: Review into the scope of economic regulation applied to covered pipelines*, 27 February 2017, pp. 128-130, AEMC recommendation 22.

<sup>49</sup> Recommendation 24.

users about the cost of providing services on a particular pipeline, or in other ways (and has the potential to be gamed).

## Arbitration

As the AEMC notes, there have been no arbitrations under the current provisions, which may be because the current framework is perceived as ineffective.<sup>50</sup> The AEMC therefore proposes a number of changes to strengthen the arbitration mechanism for covered pipelines. The ACCC broadly supports these recommendations.

In particular, the ACCC supports changes to enable joint dispute resolution hearings, noting that these provisions may not be necessary given that contract negotiations are unlikely to occur at the same time on a particular pipeline.<sup>51</sup>

The AEMC also recommends introducing a fast-tracked dispute resolution process, which would require the regulator to resolve some disputes within 50 business days.<sup>52</sup> The ACCC welcomes specifying in the NGR timeframes for the dispute resolution process because this will provide certainty to the participants. However, the ACCC cautions that resolving a dispute in such a short period of time does not seem feasible. A dispute could only be resolved in 50 days if both parties were genuinely committed to resolving dispute. If one party is obstructive or challenges the jurisdiction of the arbitrator, this will cause significant delays. It seems highly unlikely, given that requirement, that a dispute could be resolved in such a short time.

The ACCC is the arbitrator under a number of different regulatory regimes. In our experience, these arbitrations are unable to be completed in such a short timeframe. For example, the ACCC was the arbitrator for telecommunications access disputes under Part XIC. These provisions were repealed, in part because of the time it took to resolve disputes.<sup>53</sup>

The AEMC has proposed this fast-track process only for selected disputes that meet, as yet undefined, criteria.<sup>54</sup> We are concerned that only a limited number of disputes would meet the criteria to require a fast-track resolution. This would lead to the fast-track process being utilised infrequently and not acting as a constraint on the exercise of market power of service providers. We consider that such a short arbitration process is not appropriate.

## 6. Other issues

### Regulatory discretion framework

Currently rule 40 of the NGR sets out three levels of discretion that apply to the regulator when making a decision on elements of an access arrangement proposal:

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<sup>50</sup> AEMC, *Draft Report: Review into the scope of economic regulation applied to covered pipelines*, 27 February 2017, p. 141.

<sup>51</sup> AEMC recommendation 32.

<sup>52</sup> AEMC recommendation 29.

<sup>53</sup> Explanatory Memorandum, Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010 (Cth), p. 47.

<sup>54</sup> AEMC, *Draft Report: Review into the scope of economic regulation applied to covered pipelines*, 27 February 2017, p. 152.

- No discretion – the regulator has no discretion if the proposal meets the requirements of the relevant provision;
- Limited discretion – the regulator may not withhold its approval if the regulator is satisfied that the element complies with the requirements of the NGL and NGR and is consistent with any applicable criteria in the NGL and NGR; and
- Full discretion – the regulator may withhold approval if, in its opinion, a preferable alternative exists that complies with the requirements of the NGL and NGR and is consistent with any applicable criteria in the NGL and NGR.

Most elements of an access arrangement proposal are subject to full discretion. However, limited discretion applies to important elements of the proposal including conforming capital expenditure, operating expenditure, and the setting of tariffs to recover revenue. In these cases, the regulator is constrained from requiring the service provider to comply with these rules in a manner that better achieves the National Gas Objective.

The AEMC proposes removing this regulatory discretion framework and allowing the regulator full discretion on all elements of the access arrangement proposal.<sup>55</sup> The ACCC supports the recommendation because it will allow the regulator to require that the service provider complies with the requirements of the NGL and NGR in a manner that best achieves the National Gas Objective and revenue and pricing principles and, in so doing, reduce the risk of pipeline operators exercising their market power.

## Asset valuation

Rule 77 of the NGR sets out how the capital base for a covered pipeline should be calculated. For pipelines commissioned after the commencement of the NGR (2008), the opening capital base is the cost of construction of the pipeline, plus capital expenditure since commissioning, less depreciation and asset disposals.

Rule 569 of Part 23 sets out how an arbitrator should determine the asset value for an uncovered pipeline as the cost of construction of the pipeline, plus capital expenditure since commissioning, less return of capital and asset disposals.

Some stakeholders have queried whether the use of ‘return of capital’ compared with ‘depreciation’ in Rule 77 indicates that a different meaning is intended. The AEMC states that the correct view is that the term ‘depreciation’ in Rule 77 is economic depreciation.<sup>56</sup>

To address this issue, the AEMC recommends that rule 77 should be clarified to indicate that the term means economic depreciation. The AEMC goes on to state that this will give the regulator discretion as to whether past recoveries of capital should be taken into account.<sup>57</sup>

The concern we have with this recommendation is that it appears to broaden the scope for arguments about past recovery. The depreciation criteria in rule 89 already state that an asset should only be depreciated once implying that past recovery should be taken into account. By recommending that the regulator have discretion as to whether prior returns of

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<sup>55</sup> AEMC recommendation 13.

<sup>56</sup> AEMC, *Draft Report: Review into the scope of economic regulation applied to covered pipelines*, 27 February 2017, p. 109.

<sup>57</sup> AEMC recommendation 16.

capital are taken into account, the recommendation necessarily opens the door to the value of an asset being recovered more than once.

Because of this, the ACCC does not support recommendation 16. Instead, the ACCC suggests that the current drafting of rule 77 be retained.