



**Submission to the Standing Committee of
Officials of the Ministerial Council on Energy**

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**APIA Response to the SCO Consultation
Paper on the Productivity Commission's
Review of the Gas Access Regime**

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APIA Submission to the SCO Consultation Paper on the Productivity Commission's Review of the Gas Access Regime

The Australian Pipeline Industry Association (APIA) welcomes this opportunity to respond to the Standing Committee of Officials' consultation paper released on 11 August 2005.

Introduction

APIA would like to note that the Productivity Commission (PC) undertook over a two-year period detailed and extensive consultation prior to issuing its report. Many interested parties provided submissions and presentations covering all relevant issues. Given the depth and breadth of the PC's consideration of the issues, APIA believes there is no clear reason to depart from the PC's recommendations.

APIA does not agree with all the recommendations made by the PC. However, given the need for progress in improving the Gas Access Regime APIA is prepared to compromise its position on a number of matters and support the implementation of the PC recommendations as a comprehensive reform package. We ask that government recognise that industry has already compromised in this way.

APIA is most concerned with the Standing Committee of Officials (SCO) paper (consultation paper) in that the paper:

- does not accept all of the Productivity Commission's (PC) proposed changes to the Gas Access Regime (GAR) as a consistent package of reforms;
- does not provide any justification for moving away from many of the PC recommendations;
- seeks to undertake a further review process on issues which have already been the subject of an extensive consultation, which will lead to extensive delays and uncertainty at a time when clear direction and certainty is required and
- seeks to promote development of a standard energy access regime that would lead to further delays in key aspects of reform for the gas pipeline industry, ignoring the clear differences between gas pipelines and electricity infrastructure and the consequential delay that such standardisation (if possible) would cause.

APIA calls on the Government to implement the PC recommendations in full and to do so now. Industry's support of the PC recommendations is already a compromise. We believe there should be no further delay to positive and constructive reform and, therefore, propose that a government/industry working group be established to progress implementation of the PC recommendations.

This submission outlines below the problems with the alternative proposals put forward by the SCO consultation paper, highlights the deficiencies with those proposals and suggests the way forward in the reform of the national gas access regulatory regime.

Standardisation of Gas and Electricity

The proposal in the consultation paper to effectively postpone gas reform until a standardised approach is reached is likely to result in no reform at all. While industry supports consistency where efficient, we also note that in many instances there are clear differences between the electricity and gas industries. Gas laws that are a “mirror” of electricity laws in cases where there are major differences would be unworkable and create further uncertainty.

The policy goal of having consistency in the approach to economic regulation is appropriate¹. However, the assumption or “expectation” that this must be achieved in energy, and achieved through starting with a clean slate, 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 to be the same is unnecessary, inefficient and problematic.

The Way Forward

The GAR has been operating nationally since 1998 and has been substantially reviewed by the PC. It is appropriate to introduce the PC’s recommended changes as an efficient method of improving the regime for gas and to consider adopting the relevant aspects of this regime for electricity transmission and distribution as appropriate. “Sensible evolution” is better than “bulldoze what we have and start again”.

APIA considers that such an approach would:

- adopt a regulatory model that has been the subject of comprehensive review;
- build on the positive features of the existing gas regime and take an evolutionary approach to reform;
- be relatively quick in delivering an example of national uniformity;
- reduce investment uncertainty arising from the continued delay in reforms identified by the PC as necessary to improve the GAR; and
- not lead to further delays which will only create further adverse investment incentives.

This submission will now address in more detail the issues raised in the consultation paper.

¹ 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.

Objectives Clause

SCO proposal

SCO proposes two alternative options to the PC's recommended objective. The first option seeks to promote efficient investment in, and operation and use of, pipeline services for the long-term interests of consumers. The second option seeks to promote efficient investment in, operation and use of pipeline services in a way that thereby promotes the interests of consumers.

Incorporating a single overarching objective in the GAR would clarify the policy intent thereby guiding decision makers as well as promoting greater certainty for service providers and access seekers. In their submissions to the PC's review of the National Gas Access Regime, the Western Australian Government, the National Competition Council, and the Victorian Essential Services Commission supported the need for an overarching objective clause.

APIA is very concerned that the alternative objective clauses proposed by SCO would not provide sufficient guidance and certainty. In practice, the alternatives proposed in the consultation paper would introduce dual and potentially competing objectives and possibly introduce an inefficient bias in decision-making.

The first option proposed in the consultation paper seeks to promote efficient use as well as the long-term interests of consumers. The second option seeks to promote efficient use within an overall objective of the long-term interests of consumers. In effect, both of these options contain two separate objectives, economic efficiency and the long-term interests of consumers.

The problems associated with interpreting multiple objectives have been clearly demonstrated and are widely understood. The WA Supreme Court highlighted the difficulties that these multiple objectives caused for the regulator in the case of *Re Dr Ken Michael AM; ex parte Epic Energy (WA) Nominees Pty Ltd* [2002] WASCA 231; (2002) 25 WAR 511.

Regulators and courts are reluctant to ignore clear wording in an objective. Thus, regulators and courts, when interpreting the alternative objectives proposed by SCO, would be likely to treat the promotion of user interest as a separate objective from economic efficiency. This is likely to lead to a departure from a single consistent objective of efficient economic investment in, and operation and use of, pipelines.

There is also a risk in including an objective which suggests significant weight must always be placed on achieving low prices for consumers, as this increases the likelihood of reduced or distorted investment in, and maintenance of, pipelines. The inclusion of competing objectives also undermines the purpose of an overarching objective – to provide clarity and certainty.

Rationale for SCO proposal

The rationale provided in the consultation paper for proposing alternatives to the PC's recommendation is to provide consistency with the objectives for the National Electricity Legislation (NEL) and the National Access Regime.

Consistency, of itself, is not a compelling reason for change and particularly so where it leads to poor outcomes. The consultation paper fails to show that it is desirable for a single objective to govern two distinct regimes, a national electricity market and a gas access regime, where: (i) there are differences between electricity and gas supply economics; and (ii) the electricity set of rules are aimed at the establishment and maintenance of a market while the gas access regime is focussed on efficient access to infrastructure. There is also no clear demonstration that the objectives stated in the NEL are preferable to the PC's recommendation.

SCO also provides no rationale for introducing the confusion of competing objectives.

APIA understands that there is also considerable concern in the electricity industry that the NEL objective is wrong and misguided.

The Way Forward

The PC's recommended overarching objective for the GAR is:

To promote the economically efficient operation and use of, and economically efficient investment in, the services of transmission pipelines and distribution networks, thereby promoting effective competition in upstream and downstream markets.

The PC recommends making this the overarching objective binding and removing some of the existing protections for investment in pipelines in section 2.24 and 6.15. APIA accepts the Productivity Commission's recommendation in Chapter 5 in the context that it is part of a comprehensive and integrated package including the original overarching objectives clause. It is APIA's strong view that the PC's proposal provides the best outcome for consumers and investors. Changing the objectives clause as suggested by SCO, but also adopting the PC's proposed removal of the guiding factors in section 2.24 and 6.15 would reduce protection for the legitimate business interests and investments of pipeline owners and lead to further uncertainty in the industry.

The single objective of economic efficiency as expressed by the PC should underpin regulatory intervention. Focussing on developing an efficient access regime would promote the best interests of all participants and it would be unnecessary and unhelpful to change the objective as stated by the PC.

Price Monitoring

SCO Proposal

The SCO consultation paper puts forward the following proposal:

An alternative option 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. (p12)

...A simple rule for the application of monitoring could be considered – for example, one that is based upon a threshold for the materiality of the pipeline (that is, to exclude projects for which the administrative costs are high relative to the size of the pipeline). Other simple rules may be possible. (p13)

APIA considers that this proposal has a number of problems and should not be adopted by the MCE. These problems are:

- it is inconsistent with accepted economic theory that regulation should only apply where the benefits outweigh the costs;
- it is contrary to the MCE's stated desire to promote new investment in pipelines;
- it will lead to more intrusive and costly regulation;
- it is wrong to justify it by arguing that it is comparable to the monitoring regime applicable to airports ; and
- it ignores the monitoring model already proposed by the APIA and its members as part of the PC's review.

(a) Proposal is contrary to MCE objectives

APIA, among others, has consistently argued that the role of regulation should be the pursuit of economic efficiency and ensuring the establishment and maintenance of an environment conducive to socially desirable investment.² This view is also consistent with the PC findings and with the underlying premise of the Competition Principles Agreement.

Obviously, regulation should be strictly limited to circumstances where it can be clearly shown that the benefits of regulation outweigh the costs. Therefore, APIA is seriously concerned that the consultation paper proposes the imposition of regulation in circumstances where it has been shown that regulation is not warranted. Further, there is a clear implication that the additional regulation could be applied to all, or nearly all, unregulated pipelines.

² APIA Submission to the Productivity Commission Review of the Gas Access Regime, September 2003, Section 4.3

Given the PC's findings that the costs of regulation have a chilling effect on investment, the imposition of regulation on unregulated pipelines contradicts an important theme in the MCE's Supplementary Report issued in December 2003. That is, the importance of new investment in the pipeline system to ensure the delivery of reliable, competitive and secure gas supplies throughout Australia.

(b) Increased costs and regulatory intervention

APIA and pipeline owners have major concerns regarding the inevitable costs associated with any regulatory reporting scheme, together with the very real risk of increasing regulatory intervention.

The benefit of applying a monitoring regime to pipelines that do not satisfy the coverage criteria is likely to be extremely low. This is because these transmission pipelines typically provide services to a relatively small group of users, all of whom are well informed and, in many instances, possess countervailing market power.

(c) Not comparable to the monitoring regime for airports

The consultation paper also mounts the argument that such a reporting regime applies successfully in airports and has been held up as a template for other industries. This argument ignores the fact that:

- the price-monitoring regime applied to airports only applies to the major capital city airports;
- the application of price monitoring replaced existing price caps – that is, it is not in addition to a more heavy-handed form of regulation; and
- unlike the gas transmission sector where pipelines have been found to provide competing services³ and have facilitated the development of basin-on-basin competition, no major airports have directly competing alternative service providers.

In its submission to the *Productivity Commission Review of the National Access Regime*, APIA provided extensive detail regarding the limited market power enjoyed by pipeline owners and demonstrated that pipelines were likely to have significantly less market power than airports on account of lower barriers to entry and relatively higher demand elasticity.⁴

In terms of the public disclosure of pipeline tariffs, APIA notes that it is typically in the interests of uncovered pipeline owners to publicise access tariffs for spare capacity. This is a commitment of the industry's draft Code of Conduct, the principles of which were outlined in APIA's submission as part of the PC's review of the GAR.

³ Australian Competition Tribunal, *Duke Eastern Gas Pipeline Pty Ltd* [2001] ACompT 2, para 124

⁴ APIA Submission to the Productivity Commission Review of the Gas Access Regime, September 2003, Section 2.6

Rationale for the SCO proposal

The rationale in the consultation paper as to why the MCE should not adopt the PC recommendation of 2 tiers of regulation (with the first being a form of monitoring) is that the recommendation gives rise to a number of implications:⁵

- the PC’s proposed approach may not be effective under the *Trade Practices Act (TPA)*;
- “...it is questionable whether it is appropriate to apply a truly light-handed model as the default regulatory regime...to pipelines that have substantial market power...”; and
- the PC’s proposal would complicate substantially the assessment of which pipelines should be covered.

(a) Effectiveness of the PC model

There is no sound basis (in the paper or otherwise) for suggesting the PC’s proposal would not be effective under the TPA. Even with the PC’s recommended changes, the Gas Access Regime would continue to be effective because the existence of binding arbitration for those covered pipelines which are not under the light-handed regime meets the requirements of the Competition Principles Agreement. It is not a requirement of an effective regime that all infrastructure must automatically be subject to some form of price regulation. All regimes which to date have been certified as effective under Part IIIA of the *Trade Practices Act (TPA)*, envisage that infrastructure may move in and out of regulation as circumstances change.

(b) Appropriateness of light-handed approach for pipelines with material market power

The consultation paper states that it is questionable whether a light-handed approach is appropriate for pipelines with *substantial* market power. The consultation paper is incorrect, in that the PC’s proposed coverage test refers to pipelines with “material” market power not “substantial” market power.

Nevertheless, the PC devoted considerable attention to the question of whether it is appropriate to apply a light-handed form of regulation to pipelines with material market power and concluded that it was appropriate. In particular, it found that the current approach is costly and inappropriate and in order to address this problem a light-handed form of regulation was required. For the consultation paper to simply state that it is questionable as to whether it is appropriate, without any justification or analysis, particularly when considered against the extensive analysis by the PC, renders the consultation paper’s argument baseless. Moreover, the introduction of an additional layer of regulation for pipelines that have less than a “material” level of market power, as

⁵ SCO Consultation Paper, Pages 11-12

proposed in the paper, should be seriously questioned. The consultation paper does not demonstrate the need for, or benefits of, such an additional layer of regulation.

The PC recommended that where market power is at least “material” some form of regulation is required and that where that power is not markedly more than “material”, a monitoring regime is appropriate. Given the state of maturity of the Australian pipeline industry and the stated desire of the MCE to promote investment in pipelines and introduce “light-handed” regulation, the PC recommendation should be accepted. The PC recommendation also provides the continuing threat of a pipeline being moved to the heavy-handed form of coverage if there is an exercise of any residual market power.

(c) Leads to a substantial complication of the coverage process

This rationale cannot be substantiated. The consultation paper does not explain why the PC recommendation would cause substantial complication, and simply makes an unsubstantiated assertion. In contrast, the PC reached its conclusion through an extensive review and consultation process and did not identify any such concerns.

The Way Forward

APIA is strongly of the view that:

- the application of a monitoring regime to pipelines that do not satisfy the coverage criteria is not justified on economic grounds;
- the Productivity Commission’s recommendation should be adopted; and
- the guidelines to be applied by the Regulator and the Minister in order to decide which form of regulation should apply to a particular covered pipeline need to be established now, and not left to another regulatory agency to arbitrarily determine.

If Government believes more work needs to be undertaken on the PC proposal for monitoring, industry would be happy to take part in a government-industry working group to establish the two-stage regulatory regime.

Also, any form of monitoring should encompass the eight core principles contained in the APIA draft Code of Conduct which has been canvassed by the PC. These core principles are:

1. developing market-responsive pipeline services;
2. the use of non-discriminatory tariffs;
3. public disclosure of dealings with affiliates;
4. public disclosure of key contract details;
5. protection of confidential information;
6. facilitate capacity trading;
7. performing independent external audits of compliance with the principles; and
8. binding independent dispute resolution process.

Pricing Matters

SCO Proposal

The consultation paper proposes to effectively set aside the PC's 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 common set of rules for electricity and gas transmission and distribution.

The "clean slate" approach is unnecessary and inefficient. In contrast, implementation of the PC's review will build on a national regime which has applied for the past eight years. Implementation of the PC's recommendations is required to achieve efficient and effective regulation for gas; reinvention of the regime is not.

Rationale for SCO proposal

The following excerpts outline the consultation paper's view on the PC recommendations and the rationale for the proposed approach.

Regarding the specific pricing guidance, it recommended inserting a new pricing objectives clause (replacing the former section 8.1), and making a number of consequential amendments to the remaining principles in section 8. The Commission did not, however, recommend a substantial simplification to the section 8 principles, notwithstanding their complexity⁶.

and

There is currently substantial inconsistency...on the specific guidance on pricing itself between the electricity and gas industries. The provisions under both regimes are complex and as a result do not necessarily provide unambiguous guidance to regulators.

As discussed above, the objective of the development of a national approach to energy access that is currently underway is a common set of rules (to be administered by the AEMC) to guide the application of price regulation across the electricity and gas transmission and distribution sectors. It would be expected that the new common framework for energy access would enable a 'clean slate' review of the appropriate guidance on each of these matters, ensuring that regulatory best practice is adopted⁷.

The underlined sections of the consultation paper demonstrate the paper's flaws in the basic premise or the reasoning.

⁶ Consultation Paper, section 4.6 page 17, 1st bullet

⁷ Consultation Paper, section 4.6 page 17, 2nd and third paragraphs

It is incorrect to suggest that the 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 potentially competing pricing objectives in the Code be replaced by a simple three-part set of principles, which are clear, unambiguous and not competitive. Moreover, the PC's recommended principles replicate those agreed to by 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 does not explain why the pricing principles that have been agreed as the basis for consistency of access regulation nationally should not be applied for the GAR.

While there is divergence on guidance regarding pricing between gas and electricity in the Gas Code and the NER, this does not mean that the PC's recommendations should not be adopted. Similarly, it is incorrect to suggest that the Gas Code is unworkably complex, especially once the PC's recommendations are applied⁸. The guidance in the Gas Code, as proposed by the PC, provides clear and simple mechanisms for deriving pricing for third party access. To the extent that there is uncertainty in the Gas Code, the PC's recommendations have substantially dealt with this issue.

The Way Forward

APIA submits that the straightforward and efficient policy response is to implement the PC's recommendations. The PC's recommended principles replicate those agreed to by governments for the National Access Regime and are consistent with Part IIIA of the TPA which is essential to maintaining the integrity of the National Access Regime.

⁸ In particular, Recommendations 5.3 – 5.6 and 7.1 – 7.15

Specific Guidance

SCO Proposal

With regard to the matter of specific guidance on a common set of rules for pricing, this adds nothing to the proposals put forward by the PC and would lead to further uncertainty and delay in the reform process. We refer to our comments in the introduction of this submission relating to the standardisation of gas and electricity.

Rationale for SCO Proposal

The policy intent of the paper on this point is appropriate, but provides no explanation as to why the PC's recommendations do not in fact meet this requirement. The PC makes specific recommendations on how to achieve the objectives and there is no rationale in the consultation paper for starting again.

The Way Forward

The PC's recommendation is appropriate. It can and should be implemented.

Regulatory Process and Discretion

Propose/Respond Model

SCO Proposal

The consultation paper suggests that the objectives of the energy market reforms imply that a common position on these matters must be adopted as much as possible across electricity and gas industries.

The consultation paper therefore proposes that the process for national regulation might adopt the following:

Regarding the process the regulator should follow when assessing regulatory applications, the rules should include at least:

- *a right for the regulated entity to submit a comprehensive price-service proposal to be considered by the AER;*
- *a requirement to issue a draft decision;*
- *minimum time-lines for parties to make submissions; and*
- *a reduction in the complexity of the process requirements currently set out in the Gas Code.*⁹

the Productivity Commission proposed enhancements to the current process by including additional pricing guidance for regulators and refining the process, including some limitation on merit review mechanisms.

While there are some similarities between the gas and electricity codes, the regulatory processes adopted by the different codes in gas and electricity are quite different.

For example under the National Gas Code the process is based on what has been termed a “propose/respond” model, which is described in the Gas Code as:

- *The Service Provider submits a proposed Access Arrangement, together with the Access Arrangement Information, to the Relevant Regulator.*
- *The Relevant Regulator may require the Service Provider to amend and resubmit the Access Arrangement Information.*
- *The Relevant Regulator publishes a public notice and seeks submissions on the application.*
- *The Relevant Regulator considers the submissions, issues a draft decision and then, after considering any submissions received on the draft, makes a final decision which either:*
- *approves the proposed Access Arrangement; or*

⁹ Ministerial Council on Energy Standing Committee of Officials, Consultation Paper, Review of the National Gas Access Regime, August 2005, p.18

- *does not approve the proposed Access Arrangement and states the revisions to the Access Arrangement which would be required before the Relevant Regulator would approve it; or*
- *approves a revised Access Arrangement submitted by the Service Provider which incorporates amendments specified by the Relevant Regulator in its draft decision.*¹⁰

In electricity regulation the National Electricity Rules do not adopt the “propose-respond model” and instead leave the process up to the regulator.

Rationale for the SCO Proposal

The propose-respond model, if applied correctly, can provide timely and appropriate outcomes. Rather than ignoring the PC’s recommendations and developing a new model, the recommendations should be implemented in order to begin the streamlining of the process.

The Way Forward

APIA supports the PC’s recommendation for refinement of the Gas Code. If a new uniform national approach to energy regulation is required, this should be the basis for that approach.

The propose-respond model is appropriate because:

- it is consistent with the processes under Part IIIA of the TPA and with the general concepts in the CPA;
- it reflects common regulatory practice in electricity where both draft and final reports are used even though not required under the National Electricity Rules;
- it provides some protection for the property rights of asset owners by laying down formal process requirements on the regulated business, users and the regulator; and
- it best clarifies the rights of all parties and leads to a more certain and timely regulatory approvals process.

APIA recommends that the regulatory processes used in the Gas Code be retained and amended as recommended by the PC.

¹⁰ The National Gas Code, Section 2 Access Arrangements, p. 8

Ranges in Costs and the Rate of Return

SCO Proposal

SCO listed the “ranges of parameters” issue for additional consultation, despite the fact that the pricing models in gas and electricity are similar.

Rationale for SCO Proposal

The SCO comments about the “ranges” issue indicate some concern with the PC’s recommendation:

Such a criterion for decision-making may imply more disputes and cost in the future, and may counteract the objective of improving the degree of certainty over the outcomes of future regulatory decisions. It may be more appropriate to empower the AER to make the best decision it can, and to use the rules governing the process and detail of its assessment to provide the necessary certainty of outcomes.

The PC accepted the process in the GAR although it did recommend an enhancement of the propose/respond model. This included clarifying that the regulator, in assessing the service provider’s proposals, must approve a proposal where the rate of return parameter values used lie within a range of plausible estimates or that an alternative proposed method has a plausible conceptual basis.

All experts and commentators on the rate of return as given by the Weighted Average Cost of Capital (WACC) state that its values are uncertain and have a range of plausible values. This was recognised by the PC, which has stated that:

The Gas Code (s8.4) specifies three methods that can be used to determine target revenue. There are many technical issues involved in using these methods, such as the appropriate rate of depreciation, how to apportion fixed costs between different services and time periods, the appropriate rate of return on capital, and the value of the capital base. As a result, it is possible to generate a range of values for the target revenue, even using a single method. In other words the most efficient revenue cannot be known with any certainty.¹¹ (underlining added)

The suggestion in the consultation paper that such a criterion for decision making may imply more disputes and cost in the future, and may counteract the objective of improving the certainty of future regulatory outcomes is incorrect as recently demonstrated in practice. Further, the SCO paper ignores the fact that the current Code requires – at the very least – the WACC to be set by reference to a range, rather than by seeking to identify the single, forensically correct “answer”.

¹¹ Productivity Commission, op cit. p.264.

For example a state regulator in three recent gas pipeline decisions adopted the “ranges” model.¹² There is also no suggestion that the “ranges” model increases uncertainty compared with a model under which the regulator seeks to identify a single “true” WACC.

Academic consultants also recognise the existence of ranges in rates of return. For example, a key academic adviser to regulators, Prof. Lally says in a submission to the NZ Commerce Commission:

‘Given that there is some uncertainty as to the correct parameter estimates, and that the consequences of judging excess profits to exist when they do not are more severe than the contrary error, my view is that one should choose a WACC value from the higher end of the distribution’

The Australian Competition Tribunal also considered the issue of the WACC ranges in the review of the ACCC’s decision on GasNet. The Tribunal held that the requirement of the regulator under the Code is to only propose an alternative Access Arrangement when that proposed by the service provider (in this case GasNet) does not comply with the Code. In paragraph 42 of its decision, the Tribunal noted:

Contrary to the submission of the ACCC, it is not the task of the Relevant Regulator under s8.30 and s8.31 of the Code to determine a ‘return which is commensurate with prevailing conditions in the market for funds and the risk involved in delivering the Reference Service’. The task of the ACCC is to determine whether the proposed AA in its treatment of Rate of Return is consistent with the provisions of s8.30 and s8.31 and that the rate determined falls within the range of rates commensurate with the prevailing market conditions and the relevant risk.

The Tribunal also noted that consistent with the Western Australian Supreme Court decision on Epic, any decision on an Access Arrangement should reflect the underlying uncertainty of the parameters, and that the application of Reference Tariff Principles involves “issues of judgement and degree”.¹³ Given this uncertainty, plus the need to assess the proposed Access Arrangement, the Tribunal stated that the onus was on the regulator to best resolve any tensions in ways that were consistent with the legislation. In paragraph 29 of the decision the Tribunal stated:

Where the Reference Tariff Principles produce tension, the Relevant Regulator has an overriding discretion to resolve the tensions in a way, which best reflects the statutory objectives of the Law. However, where there

¹² The West Australian Economic Regulatory Authority (ERA) has made three recent decisions where the “ranges” approach has been utilised. The ERA also used a point in the range at the 90th percentile. These were the Final Decision on Alinta Gas Networks, the Final Decision of the Goldfields Gas Pipeline and the Draft Decision on the Proposed Access Arrangements for the Dampier to Bunbury Pipeline.

¹³ Full Court of the Supreme Court of Western Australia in *Re Michael Ex parte Epic Energy (WA) Nominees Pty Ltd* (2002) 25 WAR 511.

are no conflicts or tensions in the application of the Reference Tariff Principles, and where the AA proposed by the Service Provider falls within the range of choice reasonably open and consistent with Reference Tariff Principles, it is beyond the power of the Relevant Regulator not to approve the proposed AA simply because it prefers a different AA which it believes would better achieve the Relevant Regulator's understanding of the statutory objectives of the Law.

The Way Forward

APIA submits that the PC's recommendation on the issue of the "ranges" should be implemented in the national Gas Code because it is:

- supported by the empirical evidence;
- reflective of decisions by the Australian Competition Tribunal and the Supreme Court of Western Australia that a "ranges" model is required under the Code in pricing decisions by regulators; and
- consistent with recent decisions by the ACCC.

Merit Review

SCO Proposal

The SCO questions appeal rights for the gas industry, suggesting that a common set of provisions be developed in the electricity and gas law governing access in these industries. In contrast, the appeal rights currently differ, as review rights exist in gas but do not exist in electricity to any significant degree.

Any regulatory regime under which a decision maker is given considerable discretion requires an appeals system to ensure that decisions which significantly impact on infrastructure returns and investment are subject to proper scrutiny, thus ensuring accountability of decision makers and transparency in the process. Because of the extent of powers and discretion granted to the regulators under the GAR and their potential to adversely interfere with pipeline owners' property rights, the current review mechanism was included as a fundamental part of the GAR.

The SCO notes that appeal rights are being considered in a separate MCE process. APIA will seek to participate in the separate MCE process, but notes that no justification has yet been given for considering any modifications to the review rights under the GAR, or for not implementing the changes recommended by the PC.

Rationale for SCO Proposal

The SCO has provided no clear rationale for modifying current rights of review under the GAR. Similarly, SCO has also provided no explanation as to why the PC recommendations should not be introduced at this time. For example, there is no suggestion by SCO that the reasons which led to the inclusion of review rights in the GAR are in any way no longer relevant or compelling.

A perceived need for consistency is not a valid reason to remove a current right.

The Way Forward

The availability of merit review is central to optimising the quality of all regulatory systems and decision making.

The PC recommended that:

- removal of current limitations on grounds for appeal, to allow a full merits review on access arrangements drafted and approved by the regulator;
- restriction of material that can be introduced to the appeal body on a review of a coverage decision to material that has already gone before the primary decision maker.

The issue of reviews was widely analysed by the PC, leading to the conclusion that:

There is a need for a merits review under the Gas Access Regime. In the Commission's view, appropriate protection for property rights and natural justice are key considerations. While the appeal process might take considerable time and expend considerable resources, the regulatory bodies and Ministers have powers to make decisions that have an impact on fundamental rights of service providers. The prospect of exposure to imperfect regulatory instruments means there is a strong case for a merits review.

This conclusion properly recognises the basis for inclusion of existing review rights under the GAR. At the time of introduction of the GAR in 1997, the Commonwealth noted¹⁴:

The national third party gas pipeline access regulatory scheme was developed through a process which included the Commonwealth, states and territories and gas industry members – gas producers, pipeliners and major users – represented by their associations. The agreed reform arrangements reflect a sound and balanced outcome which is acceptable to all nine jurisdictions and the four peak industry associations.

The arrangements provide a balance between the right of parties to procedural fairness through an appeals process and the timeliness of regulatory outcomes. In this regard, there is provision for judicial review of decisions and administrative [ie merits] appeals for certain decisions of the regulator.”

The PC review was preceded by a number of other reviews, including the Parer review and the PC review of Part IIIA of the *Trade Practices Act*. The issue of appeals was discussed in both of these reviews and similar conclusions were reached.

There has been nothing in the experience to date under the Gas Code to remove the need for review rights which was identified in 1997 when the Code was being developed. In fact, the experience to date has demonstrated the value of review rights to all participants in the regulatory processes. Appeals have been initiated by both owners and users, and the ACCC has also exercised its right to appeal against a decision of the Australian Competition Tribunal.

APIA notes that it is open to MCE to undertake separate consultation as to the applicability of such review rights in electricity. The fact that the electricity industry does not have rights of review, and that this matter needs to be considered in that industry, does not in any sense justify delay in introducing the PC's recommendations to refine the rights of review under the Gas Code.

¹⁴ Second Reading Speech, *Hansard* 26 November 1997

Greenfields

SCO Proposal

In order to address the issue of improving incentives to invest in greenfields pipelines the PC recommended a system of 15-year binding non-coverage decisions. The SCO proposes a new option in place of the PC's recommendation. The new option is to provide all greenfields projects with an exemption from price regulation for 15 years, with non-price regulation remaining during that period. The SCO proposal also would apply only to pipelines that meet (as yet to be finalised) criteria such as having a "substantial speculative component".

APIA strongly supports the need for reforms that improve the incentives for investment in greenfields capacity. However, the SCO proposal has no process for identifying projects that have greenfields characteristics. Even if a process were developed, there would continue to be uncertainty surrounding the definition of essential characteristics of greenfields projects and how they would be applied practically. For example concepts such as "the substantial speculative component of cash flows" could be difficult to adequately define and then measure.

The SCO proposal also implies that non-price regulations would remain on greenfields projects. This approach is again moving away from the lighter-handed regulation recommended by the PC, which is designed to remove deterrents to investment. APIA strongly believes that if a pipeline is not covered then non-price regulations should not apply.

Rationale for SCO proposal

The SCO consultation paper's rationale for departing from the PC's recommendation is that the PC's recommended process might be uncertain and costly, and possibly delay investment.

The PC's recommendations provide certainty for process. Following the PC's process, the greenfields pipeline proponent has a certain outcome and can decide to develop the project or not, based on this outcome. In contrast, the consultation papers' process lacks clarity on process.

The Way Forward

The PC recommends that, prior to construction, a greenfields pipeline proponent should be able to seek an assessment as to whether the pipeline would pass the coverage test, and if the pipeline does not pass the test, a binding ruling would then be issued that would preclude coverage for 15 years. This recommendation is designed to reduce regulatory risk for greenfields pipelines. After 15 years of operation the pipeline would become covered if a coverage application demonstrated the need to regulate the pipeline.

While the consultation paper proposal claims to enhance the prospects of greenfields investment, the SCO alternative is, in fact, uncertain and less likely to be effective in providing regulatory certainty for new pipelines when compared to the PC recommendation.

The PC recommendations keep intact the delineation between covered and uncovered pipelines and do not "blur" this delineation by seeking to impose non-price obligations on greenfields pipelines.

APIA strongly supports the need for reforms that improve the incentives for investment in greenfields capacity and supports the implementation of the PC's recommendations.

Conclusion

The delays experienced to date in the Government's response to the PC report are unfortunate given the history of deliberation. The Gas Access Regime was established in 1997; the National Access Regime was reviewed in 2000; and the PC's thorough review of the GAR was conducted from 2003 to 2004. It is therefore inappropriate, only one year later, to conduct a further review and rewrite of the PC's 2004 findings.

The review of the Gas Access Regime was extensive and thorough and the PC addressed the very difficult issues, providing clear direction to government and industry. The recommendations by the PC are not all supported by industry, but in the interests of clarity and achieving necessary reform of pipeline access regulation, the industry has accepted the need for compromise and has called on government to implement in full the recommendations.

The SCO consultation paper discussed the benefits of regulation without making a strong case for regulation and without forming a view on important and related issues within the enormous body of work supporting the PC's recommendations. The SCO consultation paper accepts very few of the PC's recommendations and refers many others for further review. Further review is costly and unnecessary. It would therefore be in the interests of progressing reform for industry to work with government to develop responses to the few outstanding questions raised in the PC recommendations.

Further delays in the implementation of reforms only create further uncertainty for industry. More reviews are not needed – the process needs action.

APIA Response SCO Consultation Paper

No. PC Recommendation	Response and/or proposal in Consultation Paper	APIA Response
<p>5.1 <i>The following overarching objects clause should be incorporated into the Gas Access Regime, with the wording consistent with the Australian Government’s proposed objects clause for the national access regime:</i> <i>To promote the economically efficient operation and use of, and economically efficient investment in, the services of transmission pipelines and distribution networks, thereby promoting effective competition in upstream and downstream markets.</i></p>	<ul style="list-style-type: none"> • SCO proposes to accept the recommendation to insert an overarching objects clause in the regime. • Comments are invited on whether the new clause should be: <ul style="list-style-type: none"> (a) As proposed by the PC, ie consistent with the proposed wording in the NAR; (b) Mirror those contained in the NEL to provide consistency with electricity; or (c) In an alternative formulation that mirrors both the NEL and the wording in the NAR. <p><i>See the discussion at section 4.1 of the Consultation Paper.</i></p>	<p>As part of an integrated package of reform to the GAR, APIA endorses the Productivity Commission’s proposed objects clause and recommendation. The PC’s proposal provides the best outcome for consumers and investors. Changing the objectives clause while still removing the guiding factors in section 2.24 and 6.15 would reduce protection for the legitimate business interests and investments of pipeline owners</p>
<p>5.2 <i>For decisions about coverage, the form of regulation and regulated access terms and conditions, the relevant decision maker should be explicitly guided by the overarching objects clause.</i></p>	<p>SCO proposes to accept this recommendation.</p>	<p>As APIA supports the implementation of the PC recommendations, APIA supports SCO’s acceptance of this recommendation, but not the changes to the objectives clause proposed by SCO. The guidelines for deciding which form of regulation is to apply should be determined now (see PC recommendation 6.5)</p>

APIA Response SCO Consultation Paper

No. PC Recommendation	Response and/or proposal in Consultation Paper	APIA Response
<p>5.3 <i>With the implementation of recommendation 5.1, the following objectives in the preamble to the existing legislation and the related objectives in the introduction to the Gas Code should be deleted:</i></p> <p><i>(a) facilitates the development and operation of a national market for natural gas</i></p> <p><i>(b) prevents abuse of market power</i></p> <p><i>(c) promotes a competitive market for natural gas in which customers may choose suppliers, including producers, retailers and traders</i></p> <p><i>(d) provides for rights of access to natural gas pipelines on conditions that are fair and reasonable for the owners and operators of gas transmission and distribution pipelines and persons wishing to use the services of those pipelines</i></p> <p><i>(e) provides for the resolution of disputes.</i></p>	<p>SCO proposes to accept this recommendation.</p>	<p>As APIA supports the implementation of the PC recommendations, APIA supports SCO's acceptance of this recommendation when accompanied by implementation of the PC's recommended objects clause.</p>
<p>5.4 <i>The following elements of s.2.24 of the Gas Code do not provide necessary guidance to regulators when assessing access arrangements and should be deleted:</i></p> <p><i>(a) the Service Provider's legitimate business interests and investment in the Covered Pipeline</i></p> <p><i>(d) the economically efficient operation of the Covered Pipeline</i></p> <p><i>(e) the public interest, including the public interest in having competition in markets (whether or not in Australia)</i></p> <p><i>(f) the interests of Users and Prospective Users</i></p> <p><i>(g) any other matters that the Relevant Regulator considers are relevant.</i></p>	<p>SCO proposes to further consider this recommendation as part of the development of common rules on regulatory guidance for a national energy access regime (see recommendation 7.1 below).</p>	<p>See APIA's response to 5.1</p>

APIA Response SCO Consultation Paper

No. PC Recommendation	Response and/or proposal in Consultation Paper	APIA Response
<p>5.5 <i>The following elements of s.6.15 of the Gas Code do not provide necessary guidance to arbitrators when arbitrating disputes over access arrangements and should be deleted:</i></p> <p><i>(a) the Service Provider’s legitimate business interests and investment in the Covered Pipeline</i></p> <p><i>(b) the costs to the Service Provider of providing access, including any costs of extending the Covered Pipeline, but not costs associated with losses arising from increased competition in upstream or downstream markets</i></p> <p><i>(c) the economic value to the Service Provider of any additional investment that the Prospective User or the Service Provider has agreed to undertake</i></p> <p><i>(d) the interests of all Users</i></p> <p><i>(g) the economically efficient operation of the Covered Pipeline</i></p> <p><i>(h) the benefit to the public from having competitive markets.</i></p>	<p>SCO proposes to further consider this recommendation as part of the development of common rules on regulatory guidance for a national energy access regime (see recommendation 7.1)</p>	<p>See APIA’s response to 5.1</p>
<p>5.6 <i>An additional factor should be added to s.6.15 of the Gas Code, as follows:</i></p> <p><i>In the event of a dispute about the price of access to a non-reference service, the arbitrator should be guided by the pricing principles in s.8.1 of the Gas Code (as revised by recommendation 7.1).</i></p>	<p>SCO proposes to further consider this recommendation as part of the development of common rules on regulatory guidance for a national energy access regime (see recommendation 7.1)</p>	<p>See APIA’s response to 5.1</p>
<p>6.1 <i>The Gas Access Regime coverage criteria should provide the same threshold for coverage as declaration under the national access regime, such that a pipeline not satisfying the coverage criteria of the Gas Access Regime also will not satisfy the declaration criteria of the national access regime.</i></p>	<p>SCO proposes to accept this recommendation.</p>	<p>As part of an integrated package of reform to the GAR, APIA supports the implementation of the PC recommendations.</p>

APIA Response SCO Consultation Paper

No. PC Recommendation	Response and/or proposal in Consultation Paper	APIA Response
<p>6.2 <i>The first criterion for assessing coverage (s.1.9[a] of the Gas Code) should be amended to reflect the Australian Government’s proposed change to s.44G92)(a) in Part IIIA of the Trade Practices Act (the national access regime). That is, that the National Competition Council would need to be satisfied:</i></p> <p><i>(a) that access (or increased access) to Services provided by means of the Pipeline would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the Services provided by means of the Pipeline. The Minister would also be bound by this change as per s.1.15 of the Gas Code.</i></p>	<p>SCO proposes to accept this recommendation.</p>	<p>As part of an integrated package of reform to the GAR, APIA supports the implementation of the PC recommendations.</p>
<p>6.3 <i>The Gas Access Regime should be modified such that the Minister and National Competition Council, in making a decision and recommendation, respectively, to cover a pipeline, should also decide and recommend, respectively, the form of regulation to apply.</i></p>	<p>SCO proposes to accept this recommendation.</p>	<p>As part of an integrated package of reform to the GAR, APIA supports the implementation of the PC recommendations.</p>
<p>6.4 <i>The decision and recommendation on the form of regulation to apply should be based on an assessment of the net benefits to the economy of each form of regulation (an access arrangement with reference tariffs or monitoring option).</i></p> <p><i>Access arrangements with reference tariffs should be applied only where the net benefits of its application are markedly greater than the net benefits of the monitoring option. Otherwise the monitoring option should be applied.</i></p>	<p>SCO invites comment on the merits or otherwise of this recommendation.</p>	<p>Any form of regulation should be limited to circumstances where it can be clearly shown that the benefits of regulation outweigh the costs.</p>

APIA Response SCO Consultation Paper

No. PC Recommendation	Response and/or proposal in Consultation Paper	APIA Response
<p>6.5 <i>The Gas Access Regime should be amended to give guidance on matters that the Minister and the National Competition Council should consider in deciding and recommending, respectively, which form of regulation should apply to a covered pipeline. In determining the potential benefits of either form of regulation, the following matters should be taken into account:</i></p> <ul style="list-style-type: none"> <i>(a) the nature of demand for the commodities and services of end users of gas</i> <i>(b) the actual and potential level of competition from substitutes such as gas from other sources delivered through other pipelines, and other forms of energy such as electricity</i> <i>(c) the nature and extent of any barriers to entry in the market</i> <i>(d) the degree of countervailing power in the market</i> <i>(e) the degree of horizontal and vertical integration</i> <i>(f) any other significant factors, subject to them being consistent with the proposed new objects clause. In determining the potential costs of either form of regulation, the following matters should be taken into account:</i> <ul style="list-style-type: none"> <i>(a) direct costs of service providers, governments and users</i> <i>(b) other costs (for example, distortions in behaviour arising from timeliness, regulatory risk and regulatory error (such as the inherent difficulties in determining efficient costs for services))</i> <i>(c) any other significant factors, subject to them being consistent with the proposed new objects clause.</i> 	<p>SCO invites comment on this recommendation in the context of the two monitoring options discussed in the consultation paper.</p>	<p>APIA rejects the SCO proposal that some form of monitoring should be applied to pipelines that are not covered. The application of a monitoring regime to pipelines that do not satisfy the coverage criteria is not justified on economic grounds and the PC’s recommendation should be adopted. Guidelines should be determined now, not left for a regulatory agency to establish.</p>

APIA Response SCO Consultation Paper

No. PC Recommendation	Response and/or proposal in Consultation Paper	APIA Response
<p><i>6.6 The Gas Access Regime should be amended to provide that where a service provider potentially covered by the Gas Code lodges a Part IIIA undertaking, this should trigger an assessment (currently by the National Competition Council) and decision (by the Minister) on whether the pipeline meets the requirements for coverage under the Gas Code. The Australian Competition and Consumer Commission’s assessment of the Part IIIA undertaking should be held over, pending the outcome of the triggered coverage assessment and decision.</i></p>	<p>SCO notes that the Australian Government has introduced legislation to amend the <i>Trade Practices Act 1974</i> to remove the possibility of “forum shopping” between the National Access Regime and the Gas Access Regime.</p>	<p>APIA notes the action by the Government to address this issue.</p>

APIA Response SCO Consultation Paper

No. PC Recommendation	Response and/or proposal in Consultation Paper	APIA Response
<p>7.1 <i>In order to provide more specific and operational guidance for setting reference tariffs under the Gas Access Regime, and ensure consistency with the national access regime, s.8.1 of the Gas Code should be replaced with the following:</i></p> <p><i>s.8.1 A reference tariff or reference tariff policy should be designed with regard to the overarching objects clause, s.2.24 and the following principles:</i></p> <p><i>(a) that reference tariffs should:</i></p> <p><i>(i) be set so as to generate expected revenue for a reference service or services that is at least sufficient to meet the efficient costs of providing access to the reference service or services</i></p> <p><i>(ii) include a return on investment commensurate with the regulatory and commercial risks involved</i></p> <p><i>(b) that reference tariff structures should:</i></p> <p><i>(i) allow multi-part pricing and price discrimination when it aids efficiency</i></p> <p><i>(ii) not allow a vertically integrated service provider to set terms and conditions that discriminate in favour of its associated businesses in upstream or downstream markets, except to the extent that the cost of providing access to non-associates is higher</i></p> <p><i>(c) that reference tariffs should be set so as to provide incentives to reduce costs or otherwise improve productivity.</i></p>	<p><i>SCO invites comment on:</i></p> <p><i>(a) the pricing principles as recommended by the PC; and</i></p> <p><i>(b) the proposal in the consultation paper to develop common rules for a national energy access regime on pricing principles, regulatory guidance and regulatory process (see section 4.6 and 4.7 of the consultation paper).</i></p> <p><i>Note that SCO expects that any pricing principles developed as part of common rules for a national energy access regime would be substantially similar to the pricing principles in the national access regime and as recommended by the PC for the gas access regime.</i></p>	<p>The PC Gas reforms should be implemented now (without waiting for the development of possible common rules for a national energy market framework) because:</p> <p>(i) the PC recommendations have been considered as an integrated package which makes sense;</p> <p>(ii) waiting for the overall development of an energy market framework risks delaying worthwhile reforms.</p> <p>In respect of the SCO suggestion that the Gas Code process is complex, the SCO proposal adds nothing to the PC’s recommendations for amendments to the Gas Code. The PC recommendation should be adopted.</p>

APIA Response SCO Consultation Paper

No. PC Recommendation	Response and/or proposal in Consultation Paper	APIA Response
<p><i>7.2 To ensure there is no conflict with the pricing principles specified in recommendation 7.1, the following should be deleted from the Gas Code:</i></p> <ul style="list-style-type: none"> • <i>the overview in italics at the beginning of s.8</i> • <i>ss8.2(c), 8.3(a), 8.38–8.43 and 8.45.</i> 	See response to Recommendation 7.1	See APIA’s response to 7.1
<p><i>7.3 To ensure there is no conflict with the pricing principles specified in recommendation 7.1, the first paragraph of s.8.44 of the Gas Code should be changed to:</i></p> <p><i>s.8.44 The Reference Tariff Policy should, wherever the Relevant Regulator considers appropriate, contain a mechanism (an Incentive Mechanism) that permits the Service Provider to retain all, or any share of, any returns to the Service Provider from the sale of Reference Services in aggregate (not individual Reference Services when there is more than one):</i></p> <p><i>And s.8.46 of the Gas Code should be changed to: s.8.46 The design of an Incentive Mechanism should be consistent with achieving the overall objective of the Gas Access Regime and the pricing principles specified in s.8.1.</i></p>	See response to Recommendation 7.1	See APIA’s response to 7.1

APIA Response SCO Consultation Paper

No. PC Recommendation	Response and/or proposal in Consultation Paper	APIA Response
<p>7.4 <i>To ensure the guidance given to regulators is consistent with recommendation 7.1, s.8.6 of the Gas Code should be changed to the following: s.8.6 In view of the manner in which the Rate of Return, Capital Base, Depreciation Schedule and Non Capital Costs may be determined (in each case involving various discretions), a range of values may be attributed to the Total Revenue described in section 8.4. In order to assess whether a value proposed by a Service Provider is within this range the Relevant Regulator may have regard to any financial and operational performance indicators it considers relevant in order to determine whether the level of costs nominated by the Service Provider is within the range of plausible outcomes under section 8.4 that is consistent with the pricing principles contained in section 8.1.</i></p>	<p>See response to Recommendation 7.1.</p>	<p>.See APIA’s response to 7.1</p>
<p>7.5 <i>To provide greater flexibility for price regulation than that provided by the current building block approach, s.8.5 of the Gas Code should be replaced with the following: s.8.5 A Service Provider can use another method to calculate Total Revenue, provided the Relevant Regulator is satisfied that the proposed method is more likely to meet the overall objective of the Gas Access Regime.</i></p>	<p>See response to Recommendation 7.1.</p>	<p>See APIA’s response to 7.1</p>

APIA Response SCO Consultation Paper

No. PC Recommendation	Response and/or proposal in Consultation Paper	APIA Response
<p><i>7.6 Section 8.21 of the Gas Code should be amended so that regulators can, at their discretion, undertake less public consultation than is required for a proposed revision to an access arrangement under s.2.28. If this discretion is exercised, the regulator should issue a written statement outlining clearly why the reduced public consultation was justified prior to issuing a binding decision under s.8.21 that proposed investment in an extension or expansion of a covered pipeline would meet the requirements for incorporation into the capital base.</i></p>	<p>See response to Recommendation 7.1.</p>	<p>See APIA's response to 7.1</p>
<p><i>7.7 To ensure there is no conflict with the pricing principles specified in recommendation 7.1, s.8.26(c) of the Gas Code should be deleted.</i></p>	<p>See response to Recommendation 7.1.</p>	<p>See APIA's response to 7.1</p>

APIA Response SCO Consultation Paper

No. PC Recommendation	Response and/or proposal in Consultation Paper	APIA Response
<p>7.8 <i>To ensure there is no conflict between the depreciation provisions of the Gas Code and the pricing principles specified in recommendation 7.1, ss8.32, 8.33(a) and 8.34(d) should be replaced with the following:</i></p> <p><i>s.8.32 The Depreciation Schedule is the set of depreciation schedules (one of which may correspond to each asset or group of assets that form part of the Covered Pipeline) that is the basis upon which the assets that form part of the Capital Base are to be depreciated for the purposes of satisfying the pricing principles in section 8.1.</i></p> <p><i>s.8.33(a) so as to result in the expected Total Revenue attributable to a Service Provider's Reference Services in aggregate (not individual Reference Services when there is more than one) changing over time in a manner that is consistent with the efficient operation and use of the Services (and which may involve a substantial portion of the depreciation taking place in future periods, particularly where the calculation of Total Revenue has assumed significant market growth and the Pipeline has been sized accordingly);</i></p> <p><i>s.8.34(d) the expected Total Revenue attributable to a Service Provider's Reference Services in aggregate (not individual Reference Services when there is more than one) should change over the Access Arrangement Period in a manner that is consistent with the efficient operation and use of the Services (and which may involve a substantial portion of the depreciation taking place towards the end of the Access Arrangement Period, particularly where the calculation of Total Revenue has assumed significant market growth and the Pipeline has been sized accordingly).</i></p>	<p>See response to Recommendation 7.1.</p>	<p>See APIA's response to 7.1</p>

APIA Response SCO Consultation Paper

No. PC Recommendation	Response and/or proposal in Consultation Paper	APIA Response
<p>7.9 <i>To ensure regulators are given clear guidance about the uncertainty associated with calculating an ex ante regulatory rate of return, s.8.31 of the Gas Code should be changed to the following:</i></p> <p><i>s.8.31 If a Rate of Return is used in determining a Reference Tariff then the method used to calculate the Rate of Return and the values used in applying that method shall in the first instance be proposed by the Service Provider. In assessing the Service Provider’s proposal the Relevant Regulator must take account of the fact that there is no single correct method to determine a Rate of Return and there is often a range of plausible estimates that could be used in applying a Rate of Return method. The role of the Relevant Regulator is therefore to assess whether the Service Provider’s:</i></p> <p><i>(a) proposed method has a plausible conceptual basis; and</i></p> <p><i>(b) values used in applying the method lie within the range of plausible estimates.</i></p> <p><i>The Relevant Regulator must approve the proposed method if (a) is satisfied. The Relevant Regulator must approve the values used in applying a method if (b) is satisfied.</i></p>	<p>See response to Recommendation 7.1.</p>	<p>The PC recommendation should be implemented. This recommendation is supported by the empirical evidence and expert commentators.</p>

APIA Response SCO Consultation Paper

No. PC Recommendation	Response and/or proposal in Consultation Paper	APIA Response
<p>7.10 <i>To ensure that the Gas Code is consistent with recommendations 7.1 and 7.5, s.8.30 of the Gas Code should be changed to the following: s.8.30 If a Rate of Return is used in determining a Reference Tariff then the Rate of Return should provide a return which is commensurate with prevailing conditions in the market for funds and the risk involved in delivering the Reference Service (as reflected in the terms and conditions on which the Reference Service is offered and any other risk associated with delivering the Reference Service including that resulting from regulation).</i></p>	<p>See response to Recommendation 7.1.</p>	<p>See APIA's response to 7.1</p>
<p>7.11 <i>A study should be undertaken by a group of recognised experts in the field of financial economics that considers whether a robust method can be developed for setting businesses' expected rate of return on capital under incentive regulation. This should include a review of the use of the capital asset pricing model by Australian regulators.</i></p>	<p>See response to Recommendation 7.1.</p>	<p>See APIA's response to 7.1</p>
<p>7.12 <i>To enable regulators to assess the cost allocations used to determine a service provider's total revenue, a new clause should be inserted in s.7 of the Gas Code as follows: During the Access Arrangement Period the Service Provider should collect and maintain data on the variables used as the basis of cost allocations for the purpose of deriving Total Revenue.</i></p>	<p>See response to Recommendation 7.1.</p>	<p>See APIA's response to 7.1</p>

APIA Response SCO Consultation Paper

No. PC Recommendation	Response and/or proposal in Consultation Paper	APIA Response
<p>7.13 <i>The Gas Code should be amended so that the information that service providers are required to provide under ss2.6– 2.7 and attachment A does not include information on cost allocations between different reference services (where there is more than one) or between users.</i></p>	<p>SCO invites comments on this recommendation.</p>	<p>See APIA’s response to 7.1</p>
<p>7.14 <i>To ensure that regulators cannot use State-based powers to access information beyond that specified in the Gas Access Regime, a new clause should be inserted into s.7 of the Gas Code as follows: The Relevant Regulator for the purposes of approving a Service Provider’s Access Arrangement can only use information collected under the information collection powers specified in the Gas Access Regime.</i></p>	<p>SCO invites comments on this recommendation.</p>	<p>See APIA’s response to 7.1</p>
<p>7.15 <i>Section 3.16 of the Gas Code should be amended so that it unambiguously clarifies that any expansion of a covered pipeline will also be covered.</i></p>	<p>SCO proposes to accept this recommendation.</p>	<p>As part of an integrated package of reform to the GAR, APIA supports the implementation of the PC recommendations.</p>
<p>8.1 <i>The Gas Access Regime should be amended to provide for a light-handed form of regulation as an alternative to regulation involving an access arrangement with reference tariffs. The light-handed alternative should be a monitoring regime. It is important that the monitoring regime not develop into an intrusive and costly form of regulation.</i></p>	<p>SCO proposes to accept this recommendation in principle.</p>	<p>As part of an integrated package of reform to the GAR, APIA supports the implementation of the PC recommendations.</p>

APIA Response SCO Consultation Paper

No. PC Recommendation	Response and/or proposal in Consultation Paper	APIA Response
<p>8.2 <i>The proposed monitoring form of regulation to be incorporated into the Gas Access Regime should have the following features:</i></p> <ul style="list-style-type: none"> • <i>a third party access policy formulated by the service provider which would have some minimum requirements relating to processes for negotiating access and binding arbitration in the event of a dispute over access</i> • <i>subjecting service providers to provisions for anticompetitive conduct (the current s.13 of schedule 1 of the Gas Pipelines Access Law)</i> • <i>minimum ring fencing provisions</i> • <i>public disclosure of specified information by the service provider for monitoring purposes only (which would be well short of the ‘access arrangement information’ currently required under the Gas Code)</i> • <i>scope for the service provider to adopt, at its discretion, additional features, such as a voluntary code of conduct.</i> 	<p>SCO invites comment on the scope and required elements of a proposed monitoring regime.</p> <p><i>Note that an alternative monitoring option is proposed for comment in section 4.2 of the Consultation Paper.</i></p>	<p>The application of a monitoring regime to pipelines that do not satisfy the coverage criteria is not justified and the PC’s recommendation 8.1 should be adopted.</p> <p>The form of monitoring should be based on the 8 principles underpinning APIA’s draft code of conduct.</p> <p>The PC did not identify concerns such as those expressed by SCO in relation to complication of assessment of coverage, and SCO does not demonstrate such concerns are well founded.</p>
<p>8.3 <i>The access policy prescribed by service providers under the proposed monitoring regime should include at a minimum:</i></p> <ul style="list-style-type: none"> • <i>processes for negotiating access</i> • <i>dispute resolution procedures (including provision for binding commercial arbitration).</i> 	<p>SCO invites comment on the scope and required elements of a proposed monitoring regime.</p>	<p>See APIA’s response to 8.2</p>

APIA Response SCO Consultation Paper

No. PC Recommendation	Response and/or proposal in Consultation Paper	APIA Response
<p>8.4 <i>Under the proposed monitoring regime, to encourage service providers to provide third party access, service providers and related parties should be subject to the anticompetitive conduct provisions of the Gas Pipelines Access Law dealing with preventing or hindering access (s.13 of schedule 1 of the Gas Pipelines Access Law).</i></p>	<p>SCO invites comment on scope and required elements of a proposed monitoring regime.</p>	<p>See APIA’s response to 8.2</p>
<p>8.5 <i>Under the proposed monitoring regime, a service provider should comply with the minimum ring fencing requirements in s.4.1 of the Gas Code. However, s.4.1(e) should not apply for monitored pipelines, rather a new alternative provision should apply as follows: allocate any costs that are shared between an activity that is covered by a set of accounts described in s.4.1(c) and any other activity according to a methodology for allocating costs that is transparent and disclosed as part of the monitoring regime information disclosure requirements.</i></p>	<p>SCO invites comments on the ring fencing arrangements which should apply under either or both options for a monitoring regime.</p>	<p>See APIA’s response to 8.2</p>
<p>8.6 <i>Under the proposed monitoring regime, information disclosure requirements should involve:</i></p> <ul style="list-style-type: none"> • <i>focusing more on trend performance, including profitability</i> • <i>reporting and monitoring after the event, without any need for prior endorsement by the regulator</i> • <i>the regulator particularly recording cases where access negotiations have been unsuccessful.</i> 	<p>SCO invites comment on the scope and required elements of a proposed monitoring regime.</p>	<p>See APIA’s response to 8.2</p>

APIA Response SCO Consultation Paper

No. PC Recommendation	Response and/or proposal in Consultation Paper	APIA Response
<p><i>8.7 To improve regulatory certainty, and reduce the possibility of regulatory creep, information disclosure requirements of the proposed monitoring regime should be set out in disclosure guidelines developed prior to implementation of the monitoring regime. The National Competition Council, or another suitable organisation other than the regulator undertaking the monitoring function, should be responsible for developing this generic set of guidelines. This should involve an open and transparent consultative process. It should be the responsibility of the entity developing the guidelines (the National Competition Council, for example) to update the guidelines when substantive need arises.</i></p>	<p>SCO invites comment on the scope and required elements of a proposed monitoring regime.</p>	<p>See APIA's response to 8.2</p>
<p><i>8.8 The relevant regulator should collate and publish annually the information disclosed by a service provider under the proposed monitoring regime. Any commentary made by the regulator should be of a factual nature only, for example, the regulator should not make any determinations on the appropriateness of costs and prices.</i></p>	<p>SCO invites comment on the scope and required elements of a proposed monitoring regime.</p>	<p>See APIA's response to 8.2</p>

APIA Response SCO Consultation Paper

No. PC Recommendation	Response and/or proposal in Consultation Paper	APIA Response
<p>8.9 <i>To ensure the data disclosed by service providers under the proposed monitoring regime are accurate: chief executive officers (CEOs) should be required to sign a declaration stating that the data are true</i></p> <ul style="list-style-type: none"> • <i>financial information and financial performance measures should be certified by an auditor</i> • <i>financial penalties should be available through the courts if companies refuse to provide the required monitoring data within the established deadlines.</i> 	<p>SCO invites comment on the scope and required elements of a proposed monitoring regime</p>	<p>See APIA’s response to 8.2</p>
<p>8.10 <i>Where the proposed monitoring option is applied, it should apply for a minimum period of five years, during which there would be no shift to access arrangement with reference tariffs regulation. Following this period, monitoring would continue to apply, subject to a decision by the Minister, following a recommendation by the National Competition Council, and an application from the monitoring regulator that access arrangement with reference tariffs regulation should apply. A decision to continue with monitoring would apply for a five-year period. Any person can apply for revocation of coverage of a monitored pipeline at any time.</i></p>	<p>SCO invites comments on the time periods which should apply to pipelines subject to monitoring.</p>	<p>See APIA’s response to 8.2</p>
<p>8.11 <i>For pipelines that are covered and subject to the proposed monitoring regime, only the relevant regulator should be able to apply to the National Competition Council to shift the form of regulation to access arrangements with reference tariffs.</i></p>	<p>SCO invites comment on this recommendation.</p>	<p>See APIA’s response to 8.2</p>

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<p>8.12 Pipelines currently covered with cost-based price regulation should remain covered, and continue to be subject to the access arrangement with reference tariffs regulation. Movement from this price regulation would require an application to the National Competition Council for revocation. Following a recommendation from the National Competition Council, the Minister would make a decision on coverage, and the form of regulation where coverage is retained.</p>	<ul style="list-style-type: none"> • SCO proposes to accept this recommendation. • SCO also invites comment on the appropriate mechanisms for movement of a monitored pipeline to price regulation with reference tariffs. 	<p>As part of an integrated package of reform to the GAR, APIA supports the implementation of the PC recommendations.</p> <p>See APIA’s response to 8.2</p>
<p>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.</p>	<p>SCO addresses this recommendation in relation to its proposed response to PC recommendations 6.1, 6.2, 6.6.</p>	<p>See APIA’s response to 6.6</p>

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<p>9.1 <i>The Gas Access Regime should be amended so that the relevant Minister, after receiving a recommendation from the National Competition Council, can provide a binding no-coverage ruling for a proposed pipeline if it does not meet the coverage criteria. A binding no coverage ruling should remain in effect for 15 years from when the pipeline commences operations, unless the information relied on by the relevant Minister or National Competition Council was intentionally misleading. After 15 years of operation, a pipeline that was subject to a binding no-coverage ruling should continue to remain uncovered unless there is a successful coverage application.</i></p>	<p>SCO invites comments on the different options discussed at section 4.4 of the paper for facilitating investment in greenfield gas pipelines.</p>	<p>APIA strongly supports the need for reforms that improve the incentives for investment in greenfields pipelines. As part of an integrated package of reform to the GAR, APIA supports the implementation of the Productivity Commission’s recommendations 9.1 and 9.2. The implementation of these recommendations will improve the incentives for investment in greenfields pipelines.</p>
<p>9.2 <i>If recommendation 9.1 is implemented, then the national access regime (Part IIIA of the Trade Practices Act 1974) should be amended so that a gas pipeline cannot be declared while it is subject to a binding no-coverage ruling under the Gas Access Regime.</i></p>	<p>SCO notes that should 9.1 be implemented, a binding no-coverage ruling option would be part of the Gas Access regime. Certification of the regime as effective can provide immunity from declaration.</p>	<p>See APIA’s response to 9.1</p>
<p>10.1 <i>Section 7.1 of the Gas Code should be amended so that a service provider entering an associate contract for the supply of a reference service at the reference tariff is not required to seek authorisation. However, the service provider must provide the contract and any necessary information to the relevant regulator to satisfy the regulator that it is a contract for a reference service at the reference tariff.</i></p>	<ul style="list-style-type: none"> • SCO invites comment on this recommendation. • SCO also invites comments on how associate contracts should be handled in respect of pipelines subject to a monitoring regime. 	<p>As part of an integrated package of reform to the GAR, APIA supports the implementation of the PC recommendations.</p> <p>See APIA’s response to 8.2</p>

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<p>10.2 <i>The associate contract provisions should be amended to clarify that these provisions do not apply to asset management contracts.</i></p>	<p>SCO invites comment on this recommendation.</p>	<p>As part of an integrated package of reform to the GAR, APIA supports the implementation of the PC recommendations.</p>
<p>10.3 <i>To ensure regulators can adequately assess the costs of an associated business that undertakes activities under service agreements and contractual arrangements with a service provider in relation to a covered pipeline, the following subsections should be added to s.4.1 of the Gas Code:</i></p> <p><i>s.4.1B An Associate of a Service Provider of a Covered Pipeline that undertakes activities under service agreements and contractual arrangements with a Service Provider in relation to the Covered Pipeline must (if requested by the Relevant Regulator):</i></p> <p><i>(a) establish and maintain a separate set of accounts in respect of the Services provided to the Covered Pipeline</i></p> <p><i>(b) allocate any costs that are shared between an activity that is covered by a set of accounts described in s.4.1B(a) and any other activity according to a methodology for allocating costs that is transparent.</i></p> <p><i>s.4.1C A Service Provider when entering service agreements and contractual arrangements with an Associate for activities undertaken in relation to a covered pipeline, must ensure that the terms and conditions of the contract will allow s.4.1B to be implemented.</i></p>	<p>SCO invites comment on this recommendation (see section 4.7 of the consultation paper).</p>	<p>As part of an integrated package of reform to the GAR, APIA supports the implementation of the PC recommendations.</p>

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<p>10.4 <i>To ensure regulators can adequately assess the costs of an associated business that undertakes activities under service agreements and contractual arrangements with a service provider in relation to the covered pipeline, the following subsection should be added to s.4.2 of the Gas Code: s.4.2A In complying with ss4.1B(a) and (b) an Associate of a Service Provider must:</i></p> <p><i>(a) if the Relevant Regulator has published general accounting guidelines for Associates which apply to the accounts being prepared, comply with those guidelines; or</i></p> <p><i>(b) if the Relevant Regulator has not published such guidelines, comply with guidelines prepared by the Associate and approved by the Relevant Regulator or, if there are no such guidelines, comply with such guidelines (if any) as the Relevant Regulator advises the Associate apply to that Associate from time to time. Such guidelines may, amongst other things, require the accounts to contain sufficient information, and to be presented in such a manner, as would enable the assessment (and benchmarking) by the Relevant Regulator of the costs of the activities undertaken in relation to the Covered Pipeline by an Associate under service agreements and contractual arrangements with a Service Provider.</i></p>	<p>SCO invites comment on this recommendation (see section 4.7 of the consultation paper).</p>	<p>As part of an integrated package of reform to the GAR, APIA supports the implementation of the PC recommendations.</p>
<p>10.5 <i>To remove potentially conflicting objectives from the Gas Access Regime, s.4.1(e) of the Gas Code should be amended to delete reference to the term ‘otherwise fair and reasonable’.</i></p>	<p>SCO invites comment on this recommendation (see section 4.7 of the consultation paper).</p>	<p>See APIA’s response to 5.1</p>

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No. PC Recommendation	Response and/or proposal in Consultation Paper	APIA Response
<p>11.1 <i>The Gas Access Regime should be amended, whereby the regulator would be able to extend the period for approval of an access arrangement by two months only once. If judicial proceedings commence, the regulator's time should automatically be extended by the length of time taken to complete the judicial proceedings.</i></p>	<p>SCO invites comment on this recommendation, noting that regulatory process is to be further considered as part of the development of common rules for regulatory process under a national energy access regime.</p>	<p>See APIA's response to 7.1 and 7.2</p>
<p>11.2 <i>The Gas Access Regime should be amended whereby the 'further final decision' should be removed from the approval process for access arrangements.</i></p>	<p>SCO invites comment on this recommendation, noting that regulatory process is to be further considered as part of the development of common rules for regulatory process under a national energy access regime.</p>	<p>See APIA's response to 7.1 and 7.2</p>
<p>11.3 <i>The Gas Access Regime should be amended so regulators can specify a date by which the service provider must submit proposed amendments to an access arrangement.</i></p>	<p>SCO invites comment on this recommendation, noting that regulatory process is to be further considered as part of the development of common rules for regulatory process under a national energy access regime.</p>	<p>See APIA's response to 7.1 and 7.2</p>
<p>11.4 <i>Limitations on the grounds of appeal under s.39 of the Gas Pipelines Access Law should be removed to allow a full merits review on access arrangements drafted and approved by the regulator. This would be consistent with the grounds of merits review for coverage decisions.</i></p>	<p>A MCE SCO consultation paper will be released later in 2005 to canvass views on the issue of merit review principles and the decisions under the NEL and NGL which may be appropriate for merits review.</p>	<p>SCO does not give any explanation as to why the PC recommendations should not be introduced at this time nor why there should be any suggestion that the existing review rights should be otherwise modified. There has been nothing in the experience to date under the Gas Code to remove the need for review rights which was accepted as a fundamental aspect of the GAR in 1997.</p>

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<p>11.5 <i>The material that can be introduced to the appeal body for a merits review of a coverage decision under s.38 of the Gas Pipelines Access Law should be restricted to material that has already gone before the primary decision maker. This would be consistent with the merits review process for access arrangements drafted and approved by the regulator.</i></p>	<p>See response to Recommendation 11.4.</p>	<p>See APIA's response to 11.4</p>
<p>12.1 <i>The agency that recommends coverage of a pipeline, should also be responsible for recommending the form of regulation to apply to the pipeline.</i></p>	<p>SCO will consider this recommendation as part of the further consideration of the scope and requirements of a monitoring option.</p>	<p>See APIA's response to 8.1</p>
<p>12.2 <i>The agency responsible for making recommendations on pipeline coverage and form of regulation decisions (currently the National Competition Council) should be separate from the regulator actually responsible for administering the regulation (either monitoring or access arrangements with a reference tariff).</i></p>	<p>SCO proposes to accept this recommendation.</p>	<p>As part of an integrated package of reform to the GAR, APIA supports the implementation of the PC recommendations.</p>