



**Joint Submission**

**Ministerial Council on Energy  
Standing Committee of Officials**

**National Gas Law  
Exposure Draft**

**19 December 2006**



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## List of abbreviations

<b>ACCC</b>	Australian Competition and Consumer Commission
<b>AEMA</b>	Australian Energy Market Agreement
<b>AEMC</b>	Australian Energy Market Commission
<b>AER</b>	Australian Energy Regulator
<b>CPA</b>	Competition Principles Agreement
<b>ERA</b>	Economic Regulation Authority (WA)
<b>ERA Act</b>	<i>Economic Regulation Authority Act 2003 (WA)</i>
<b>Expert Panel</b>	Expert Panel on Energy Access Pricing
<b>Gas Code</b>	National Third Party Access Code for Natural Gas Pipeline Systems (part of the GPAL)
<b>GMLG</b>	Gas Market Leaders Group
<b>GPAL</b>	Gas Pipelines Access Law
<b>GRIO</b>	general regulatory information order
<b>Law, the</b>	National Gas Law Exposure Draft
<b>MCE</b>	Ministerial Council on Energy
<b>Minister</b>	the relevant Minister – Federal, State or Territory – exercising powers under the National Gas Law according to whether the pipeline system is intra- or inter-jurisdictional
<b>NCC</b>	National Competition Council
<b>NEL</b>	National Electricity Law
<b>NER</b>	National Electricity Rules
<b>NGL</b>	National Gas Law Exposure Draft
<b>NGR</b>	National Gas Rules Exposure Draft

<b>PC</b>	Productivity Commission
<b>regulator, the; regulators, the</b>	Australian Energy Regulator and Economic Regulation Authority (WA), unless the context indicates otherwise
<b>SCO</b>	Standing Committee of Officials of the Ministerial Council on Energy
<b>TFP</b>	total factor productivity
<b>TPA</b>	<i>Trade Practices Act 1974</i> (Cth)
<b>Tribunal</b>	Australian Competition Tribunal

## Overview of submission

The NGL Exposure Draft is a further step towards a nationally consistent and streamlined regulatory regime for access to gas pipeline infrastructure. The draft fulfils the MCE policy statement of 19 May 2006 endorsing the proposed 2006 legislative package for the energy industry.<sup>1</sup> In that spirit, the designated regulators under the NGL – the AER and ERA – make this joint submission.

The submission consists of 2 parts:

1. pp **5-11**: discussion of where the draft NGL effectively addresses MCE policy objectives of the gas access reform and market development process; and
2. pp **13-29**: proposals for enhancing the draft NGL so as to more effectively achieve, in its administration, the policy objectives of the Law.

The regulators use a framework of reform principles (p **3**), derived from reports and policy statements in the reform process, as the basis for evaluating issues raised in this submission.

### Part 1

The AER and ERA discuss a number of features of the NGL that will support the policy objectives for their regulatory operations, particularly streamlined process. In addition to the overarching objective of the Law, the regulators make particular mention of:

- provisions to foster interaction between service provider and regulator and to manage information relevant to an access approval, integrating consultation obligations before new information-gathering powers are exercised (pp **6-8**);
- provisions confirming the treatment of extensions and expansions as parts of the covered pipeline, resulting in flexibility for both the service provider and the regulator to establish the terms on which services using an extension or expansion will be provided e.g., as a reference service or as a negotiable service (p **8**);
- judicial review and, to manage the increased responsibilities of the Tribunal, continued limited merits review of regulatory decisions, now with specific provision for intervention by representative bodies – consultation procedures applying to the decision-maker provide a first opportunity to address contentious issues, which may avert the formality and expense of merits review (pp **8-9**);
- phased introduction of TFP analysis, enabling the regulators to accumulate useful data first, which would assist future policy consideration of TFP methodology (pp **9-10**);

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<sup>1</sup> Ministerial Council on Energy, Communique, Darwin, 19 May 2006; see also Standing Committee of Officials of the Ministerial Council on Energy, *Statement of Scope: A National Legislative Package for Gas and Electricity*, July 2006, which elaborates on the agreed package.

- continuation of Gas Code ring-fencing provisions so as to assure user interests that market power of a service provider is not used to favour associates (p **10**);
- regulatory reporting on the operational and financial performance of service providers, contributing to the development of an informed market, likely to be conducive to greater trading activity and transparency, thereby addressing market needs arising from the change to lighter regulation and the relative infrequency of reviews under full access regulation, and supporting the work of the Gas Market Leaders Group (pp **10-11**).

## **Part 2**

The AER and ERA propose the following matters for consideration by MCE officials so as to improve the effectiveness of the NGL in meeting its policy objectives:

- clarifying the purpose of cl 24(4) so that its operation will align with the policy intention of the Expert Panel and MCE officials, that the Rules provide for methodologies such that assessment of an element of an access arrangement would be ‘fit for purpose’ (pp **13-14**);
- reconsidering the options for defining a reference service so as to avoid the need for the AEMC, as the rule-making body, to become further involved in regulation (pp **14-15**);
- tightly defining the circumstances in which Rules would replace the Law’s procedure for deciding a proposed variation to an access arrangement, so that the provision in cl 186(3) does not have consequences that were not expected by policy-makers (pp **15-16**);
- clarifying the operation of some ring-fencing provisions so as to assure a consultative process in relation to the persons to whom NGL obligations apply and to adopt Gas Code criteria for exempting persons from the minimum ring-fencing obligations (pp **16-17**);
- adopting Gas Code provisions for prudent discounts and rebatable services to give greater incentives for service providers to negotiate on price and use capacity more efficiently for the benefit of the service provider and users (pp **18-19**);
- achieving a consistent and clear test for price discrimination (i) by stating, in the Explanatory Memorandum, that whether a price discount is ‘conducive to efficiency’ will be interpreted according to normal procedures for statutory interpretation: (ii) by deleting the second limb of permitted price discrimination (where it has ‘some other rational economic basis’); and (iii) clearly establishing that terms for contracts with associates should be no more favourable than for other users (pp **20-24**);
- clarifying certain information-management issues as to the circumstances in which the regulator would make assumptions in response to assumptions of the service provider (pp **24-25**);



- clarifying the regulatory approach to late submission of substantially new issues in an access arrangement approval process (pp **25-26**);
- enhancing the clock-stopping provisions to recognise parallel procedures where the time for renewal of an access arrangement coincides with an application for light regulation or revocation of coverage (p **26**); and
- amending the unusual presumption that if the Tribunal awards costs in a merits review, the order for costs be on an indemnity basis, so as to enable the Tribunal to exercise a discretion in line with established practice in the common law (pp **27-29**).



## **Preface**

### **MCE consultation process**

The Australian Energy Regulator (AER) and Economic Regulation Authority (ERA) welcome the opportunity to participate in the NGL consultation process.

The AER and ERA would be pleased to elaborate on their comments should that be of assistance to MCE officials.

### **Regulators' approach in this submission**

This submission is written from the perspective of the AER and ERA as designated regulators of access to gas pipeline systems responsible for administering the National Gas Law (NGL), Regulations and Rules in their respective jurisdictions.

The submission does not address policy questions but does comment on the likely effectiveness of certain provisions of the NGL Exposure Draft in achieving their policy objectives.

The co-operation between the AER and ERA in preparing this joint submission is intended to give practical effect to the reform objective of regulatory consistency under uniform jurisdictional legislation. For ease of explanation, references in this submission to proposed provisions of the NGL should also be read as references to corresponding provisions of the National Gas Access Law to be introduced in Western Australia as a Schedule to the proposed *National Gas Access (Western Australia) Act 2007* (WA).

### **Legislative framework for economic regulation of gas pipelines**

Pursuant to the Australian Energy Market Agreement (AEMA), the AER was established in May 2005 under the *Trade Practices Act 1974* (Cth) as the new regulator of energy markets.

The AEMA, which was extensively amended in the first half of 2006, provides a program for the progressive transfer to the AER of economic regulatory functions at each level of the electricity and gas industries in the various Federal, State and Territory jurisdictions (other than in respect of energy in Western Australia (below) and electricity in the Northern Territory).<sup>2</sup> For gas networks and for those electricity matters not already regulated by it, the AER's operational responsibility is scheduled to become effective in the period July 2007 to January 2008. Preparatory work is already underway.

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<sup>2</sup> Under the amended Australian Energy Market Agreement, cl 6.3(d)(ii), the Northern Territory has discretion, in consultation with the MCE, to become subject to the jurisdiction of the AEMC [the rule-maker] and the AER in respect of electricity.

As part of the AEMA program, when it commences, the NGL will establish AER responsibility for regulating arrangements for third-party access to gas transmission and distribution pipelines and transparency in each service provider's dealings with its associates. AER operations will build on the work, under the Gas Pipelines Access Law (GPAL) and Gas Code, of jurisdictional regulators and of the Australian Competition and Consumer Commission (ACCC). The AER has advised the ACCC on energy regulatory issues since the AER's inception.

In Western Australia, ERA is the independent economic regulator overseeing regulation in the State for the gas, electricity, water and rail industries and conducts inquiries referred by the State Government. ERA operates under the *Economic Regulation Authority Act 2003* (ERA Act, WA) and industry-specific legislation such as the GPAL enacted pursuant to application Acts of the State Parliament. That will also be the case with the proposed National Gas Access Law, which will implement the NGL in Western Australia. Under the NGL, ERA would remain the local regulator for transmission and distribution gas pipelines. ERA does not set retail prices and this function is not being given to ERA as part of the current energy reform arrangements. The regulatory regime for electricity in Western Australia is separate from and different to that applying in the national electricity market under the NEL.

## **Principles underlying the current regulatory reforms**

The development of the Exposure Draft of the NGL can be charted from the Parer report of 2002 on the requirements for a national and truly efficient energy market; through the Productivity Commission (PC) report of 2004 assessing the benefits and costs of the current gas access regime (in the GPAL and Gas Code); and the COAG Competition and Infrastructure Reform Agreement of February 2006; to the Expert Panel report of April 2006 on achieving a common approach to revenue and network pricing across the gas and electricity industries.

At each stage, the policy response was informed by inter-jurisdictional discussions of officials reporting to the Ministerial Council on Energy (MCE). Themes consistent with and complementary to the above program run through the June 2006 report of the Gas Market Leaders Group (GMLG) on initiatives to develop a competitive, secure and reliable gas market.

While there are differences of emphasis and approach between the various reports and policy review stages, a set of primary and subsidiary principles are discernible, from the published reports and MCE officials' policy statements, as having informed the whole process.

The AER and ERA would express that framework of principles, which we term the ‘reform principles’, in the following way:

### **The reform principles**

A. A principled approach will be used for regulating infrastructure and exempting it from regulation:

1. the overriding principle for regulation is to achieve the express overarching legislative objective of encouraging efficient investment in, and efficient operation and use, of services for the long-term interests of consumers.

B. The regulatory scheme will maximise certainty and minimise compliance costs of regulation for stakeholders:

1. a nationally consistent approach to energy regulation;
2. the lightest form of regulation and dispute settlement will be available that is consistent with curbing potential misuse of market power; and
3. prior consultation with relevant stakeholders will occur on new compliance obligations arising whether by Law or Rules or exercise of regulatory powers.

C. Administration will be simple and effective:

1. transparent regulatory processes;
2. streamlined process and timeframes;
3. information-gathering powers sufficient to discharge regulatory functions; and
4. sanctions sufficient to secure compliance with the law.

The AER and ERA use that framework of principles as the basis for evaluating the issues raised in this submission.



## **1. NGL provisions supporting regulatory operations**

The NGL Exposure Draft is a further step towards a nationally consistent and streamlined regulatory regime for access to essential gas pipeline infrastructure.

The AER and ERA comment on their likely approaches to administering a number of provisions of the draft NGL that are new to gas regulation, with a view to clarifying perceptions about how they may operate.

### **Common overarching objective for gas and electricity legislation**

The regulators welcome an express overarching objective for the NGL that gives emphasis to the interests of all stakeholders. Stakeholder consumer interests are identified in the draft Law to include direct users, prospective users and end-users and their representative associations – consumers include large industrial users and retailers.

Subject to parliamentary approval, when the National Electricity Law (NEL) is amended, the national gas and electricity objectives will align. The overarching objectives inform decisions of the Minister, NCC, AEMC, AER and ERA, on whether and how to regulate.

That the ‘primary focus of the NGL objective is economic efficiency’ is apparent from the conjunction, in the NGL, of the national gas objective (cl 20) with the revenue and pricing principles (cl 21) and the conjunction of the national gas objective and revenue and pricing principles with the manner in which the regulator must exercise an ‘AER [or ERA] economic regulatory function or power’ (cll 27 and 5).<sup>3</sup> These provisions are tied together by cl 2, which identifies the main purpose of the Law in establishing the regulatory framework (in which those provisions are key elements). Achieving economic efficiency is in the long-term interests of users and end-users, and from the perspective of service providers as consumers and sometimes competitors of other suppliers’ services, in service providers’ own interests.

In the regulators’ view, that is a point that would bear emphasis in the Explanatory Memorandum that accompanies the Law in its final form when introduced to the parliaments of the participating jurisdictions.

The overarching objectives complement COAG’s decision to establish a multi-jurisdictional regulator, and West Australian adoption of mirror legislation, so as to promote nationally consistent regulation of service providers.

The overarching objectives for the regulation of energy infrastructure are designed to achieve economic efficiency in the energy infrastructure sector, reflected in investment in, and operation and use of its services. That serves the long-term interests of consumers, including

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<sup>3</sup> Standing Committee of Officials of the Ministerial Council on Energy, *2006 Legislative Package: Gas Legislative Framework*, November 2006, p 8.

the interests of the energy sector itself. The AER and ERA submit that that point is worth repeating and emphasising in the Explanatory Memorandum.

## **Decision-making and information for regulatory decisions**

Decisions will follow a streamlined administrative process in which submissions from interested persons will continue to play an important part, consistently with reform principles C1, of regulatory transparency, and C2, of streamlining.

As an example of this streamlining, a regulatory decision on whether to approve a new access arrangement will be made within 6 months of initial application, with scope for only one extension, of 2 months, for complex matters. This timetable will be made achievable by provisions in the NGL for:

- a pre-lodgement conference with the applicant;
- clock-stopping while necessary information is obtained under NGL provisions;
- limitations, after the service provider lodges its application, on the submission of new information and revisions, other than in response to the regulator's draft decision or a material change of circumstances;
- provision for the regulator to make reasonable assumptions when information is not forthcoming or is based on an assumption; and
- elimination of the Gas Code 'further final decision' step in the event that the regulator decides not to approve a proposed access arrangement.

Three of the new features mentioned above bear some elaboration to indicate the approach the AER and ERA would take to administering them.

### **Regulators' approach to proposed regulatory information instruments**

Information-gathering powers in the draft NGL have been modelled on corresponding provisions of the Gas Code and NEL, with new provisions for regulatory information instruments.

The draft NGL provides for the regulator to issue general regulatory information orders (GRIOs) and, to particular service providers, regulatory information notices. These provisions would enable the regulator to specify the manner and form in which information should be kept and provided to the regulator for the purpose of analytical work in carrying out its functions. The AER and ERA anticipate that the provisions would have primary application to ring-fencing, information supporting a proposed access arrangement and, in respect of light regulation services and international pipeline services operating under a price regulation exemption, to periodic reporting obligations of those service providers. These are 'AER [or ERA] economic regulatory functions or powers'.



They would provide the regulator with the means to frame templates that entities could follow so as to provide information on a basis that is consistent over time and consistent with the approach of other entities, to the extent that that is appropriate. The regulator's reporting functions (described below) in turn provide the means for the regulator to assure other service providers and user interests of the entity's compliance with the Law. It is expected that consistency in keeping information in accordance with GRIOs would assist in analysis undertaken by a service provider or regulator for purposes of determining compliance with an obligation or condition of exemption to which a pipeline service provider is subject.

These regulatory instruments could be issued only after consultation; and in the case of GRIOs, following a public invitation to make submissions. Consistently with reform principle B3 of prior consultation on regulatory obligations, such consultation processes, and submissions made by parties in response to the NGL Exposure Draft, should further inform the AER and ERA with respect to the necessity and design of instruments so as to avoid unnecessary costs of compliance. Consultation should also inform the regulator as to whether to grant binding exemptions so as to allow for differing circumstances of entities (NGL cl 53). Differing circumstances might include the peculiarities of accounting systems or differences between transmission and distribution system operators.

GRIOs will assist regulators to secure information needed to ensure the effectiveness of measures to both streamline approval of access arrangements and address concerns about the adequacy of ring-fencing. The requirements for consultation with stakeholders support the transparency of the arrangement and the objective of minimising compliance costs, and will support the policy objectives of timely regulatory decisions.

### **Regulators' approach to limitations on the submission of new information and revisions**

This is dealt with below, in Part 2 of this submission.

### **Regulators' approach to assumptions under cll 170(3)(c) and 178(3)**

The NGL makes provision for the regulator to adopt reasonable assumptions (including assumptions that may be adverse to the interests of the service provider) in two contexts, as follows:

- where the service provider or associate has not complied with a regulatory information instrument (cl 54(2)); and
- where the service provider has made an assumption or not provided information required by the regulator in the course of assessing an access arrangement (cll 170(3)(c) and 178(3)).

In accordance with the reform principle that sanctions should be sufficient to secure compliance with the law (C4), the provisions enabling the regulator to make an assumption where a service provider or associate has not provided necessary information provides an incentive to that entity to meet the objectives of the regulatory regime.

The interests of service providers and associates are protected by judicial review and, assuming the Regulations designate the relevant decisions as reviewable, by merits review of the reasonableness of the regulator's decision.

In Part 2 of this submission, the AER and ERA comment on the provision for the regulator to make reasonable assumptions in response to an assumption by a service provider, and make suggestions for clarifying that provision.

## **Treatment of extensions and expansions**

Clauses 15 and 16 establish when an extension to or expansion of a covered pipeline, whether operating under a light or non-light form of regulation, will be treated as part of the covered pipeline. For a pipeline operating under a light form of regulation, coverage of the extension or expansion is automatic, but the regulator can waive this requirement.

Where a covered pipeline is subject to non-light regulation, it must have an access arrangement. An access arrangement must include extension and expansion requirements, which establish whether the services to be provided over an extension or expansion will be reference services or services available on negotiable terms.

The AER and ERA consider that these provisions provide flexibility for both the service provider and the regulator to establish the terms on which services using an extension or expansion will be provided e.g., as a reference service or as a negotiable service.

## **Limited merits review of decisions**

The NGL Exposure Draft provides for judicial review and limited merits review of decisions under the NGL (other than decisions to exempt greenfield international pipeline projects from price regulation).

The grounds for merits review by the various decision-makers are based on those applying to the regulator under the GPAL. There will now be a single national merits review body, the Australian Competition Tribunal. The NGL makes specific provision for intervention by associations representing user interests.

A limitation on new information to be considered, unless it would assist the Tribunal and was not unreasonably withheld from the original decision-maker, and a new power to remit matters back to the original decision-maker to make the decision again, should assist the Tribunal in managing its increased responsibilities. Should an issue proceed to review, the ability to present new information to the Tribunal, under cl 288, provides opportunities for abuse of the review process by service providers and/or interested parties. By allowing new information to be considered by the Tribunal and regulatory decisions to be modified, the approach can also undermine the proper assessment of a proposed access arrangement in that the regulator's ability to rebalance all considerations of the original decision in light of the new information may be precluded. In view of this, the Tribunal would need to give careful consideration to whether new information may be submitted to the Tribunal.

Mandatory consultation requirements in the course of arriving at regulatory decisions would operate before a party needed to consider applying to the Tribunal to review a decision. Those consultation requirements would provide a first opportunity to address contentious issues, without the formality and expense of the merits review process. Examples of such consultation requirements are the obligation on the regulator to invite written submissions in response to a draft decision on an access arrangement (cl 172), the provision to extend the consultation period for material revisions proposed by an entity (cl 175); and the general procedural provisions applying to other types of regulatory decisions (Part 8.5, especially cll 354-357, and cl 359, the limited provision to extend the time in which to make a decision).

In the regulators' view, these provisions give effect to the reform principles of pursuing a nationally consistent approach to regulation (B1) and prior consultation with stakeholders on the exercise of regulatory powers (B3) in the context of streamlined process and timeframes (C2).

## **Revenue and pricing principles and phased introduction of TFP analysis**

The NGL adopts recommendations by the Expert Panel for revenue and pricing principles to guide the AER and ERA in making economic regulatory decisions (see cl 27). The principles were developed following public consultation and earlier policy deliberations over the NEL. In the way they are incorporated in the NGL they correspond with pricing principles in the national access regime under the Trade Practices Act. There, the principles in Part IIIA of the TPA provide guidance to the regulator so as to promote consistency of regulatory approach in assessing proposed access undertakings or codes.<sup>4</sup>

The similarities in language between the TPA and NGL provisions indicate the similarities in the way they operate. That is, they are matters that the regulator 'must' or (if not considering price or revenue) 'may' take into account in exercising regulatory discretions (*cf* NGL cl 27(2)). The word 'should' in NGL cl 21 indicates the guiding role they play in regulatory decisions on revenue and pricing issues, while suggesting and recognising that they involve a 'design' element – that is, the regulator can exercise discretion in the way the principle is applied to an access arrangement or determination so as to address the particular circumstances of the service provider.

Clause 70 envisages that any introduction of total factor productivity (TFP) analysis as a regulatory methodology would not occur without the concurrence of jurisdictions in making new Regulations, and that its use as an aid to analysis would be subject to rule-making following a process of consultation. Phasing in TFP in this way, as recommended by the Expert Panel, will give the AER and ERA the opportunity to accumulate useful time series data in the meantime, pursuant to information-gathering powers under the NGL. The data the AER and ERA gather would assist in future policy discussion of the appropriate role of TFP methodology and analysis, and regulation in future periods that might draw on the historic data.

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<sup>4</sup> See TPA ss 44ZZA(3)(ab) and 44ZZAA(3)(ab) and, in relation to arbitrating access disputes, s 44X(1)(h).

These provisions are consistent with the reform principle (B3) of prior consultation with relevant stakeholders before new compliance obligations are introduced. Data accumulated by the AER and ERA could inform any such consultations in the future.

## **Ring-fencing provisions**

The ring-fencing provisions follow the Gas Code in setting out minimum obligations and conferring regulatory power to specify additional ring-fencing requirements applicable to individual service providers.

The ring-fencing provisions are integral to the gas access regime because they provide an assurance to users and prospective users that the service provider is not using its market power arising from the ownership or operation of unique infrastructure to favour its associates.

In Part 2 of this submission, the AER and ERA make suggestions to facilitate the effectiveness in operation of proposed new ring-fencing provisions.

## **Regulatory reporting on the operational and financial performance of service providers**

The NGL provides for the regulator to publish reports on the financial and operational performance of one or more service providers (c11 26(1)(f) and 59). The AER and ERA may make use of information gathered in the course of their regulatory activities, but may not use regulatory information instruments solely for the purpose of gathering information to report on financial and operational activities. In addition, the regulator may publish the annual reports of service providers on the outcome of access negotiations for lightly regulated pipelines and international pipelines operating under price regulation exemptions. The NGL incorporates confidentiality protections modelled on those in the Gas Code.

In the regulators' view, provisions for regulatory reporting are necessary given the introduction of light regulation and price-regulation exemption and, in the case of non-light regulation services, the infrequency afforded review of the service provider's operations as a result of the usual 5-year interval between resets of a full access arrangement.

Regulatory reporting would contribute to the development of an informed market, which is likely to be conducive to greater trading activity and transparency. Informed market activity is necessary for realising the national gas objective of fostering efficient investment and the MCE plan to develop a competitive, reliable and secure gas market. It is the view of the AER and ERA, that the NGL regulatory reporting functions would complement the recommendations of the GMLG to support market development, especially recommendations for a bulletin board, short-term trading market and national gas supply/demand statement.<sup>5</sup>

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<sup>5</sup> Gas Market Leaders Group, Report to the Ministerial Council on Energy: *National Gas Market Development Plan*, June 2006, pp 3-7.

The AER has already initiated annual reporting on the performance of electricity transmission network service providers. The AER's first such report gives an indication of the way in which the AER would approach reporting on matters falling within the reporting function of the NGL.<sup>6</sup>

In general terms, reporting provisions serve the purposes of regulation if they strike a balance between, on the one hand, making regulation sufficiently transparent to users and prospective users that they may become reasonably well-informed purchasers, and, on the other hand, commercial concerns that information-gathering should not be unnecessarily intrusive. The view of the AER and ERA is that the relevant provisions are consistent with the reform principles of transparent regulatory processes (C1), adopting the lightest form of regulation that will be effective in curbing potential misuse of market power (B2).

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<sup>6</sup> Australian Energy Regulator, *Transmission Network Service Providers: Electricity Regulatory Report for 2004/05*, April 2006.



## 2. Proposals for enhancing the operational effectiveness of the NGL

### Issues for discussion

#### 1. Clarify clause 24 dealing with ‘propose-respond’

Sub-clauses 24(1)-(3) of the NGL incorporate a presumption against following the ‘propose-respond’ model of assessing an access arrangement, i.e., a presumption against accepting an access arrangement, partly or wholly, in the form submitted by the service provider.

Under cl 24(4), the Rules may reverse that presumption under the Law, in respect of ‘any aspect or element’ or ‘the whole’ of the arrangement. Providing for a rule-maker to reverse the effect of a provision enacted by Parliament is unusual, particularly in a legislative framework in which the overarching legislative objective and express principles govern the exercise of the regulator’s functions and powers and there is provision for the AEMC to make rules on regulatory methodologies (NGL Schedule 1).

The PC report had recommended that the gas access regime incorporate a ‘propose-respond’ model for assessing the service provider’s rate of return, capital and operating expenditure and depreciation. Under this model, the regulator would accept the service provider’s proposal if the method and values proposed were ‘plausible’. The Expert Panel subsequently rejected this approach as uncertain and unprecedented. The Expert Panel also expressed a view that changing the acceptance criterion from ‘plausibility’ to ‘reasonableness’ would not overcome the perverse incentive a model along those lines could give a service provider to make an ambit claim.

One outcome the Expert Panel wished to avoid was a formulation of propose-respond that would lead to systematic upward bias in returns to service providers. This led to the Panel’s recommendation that the NGL not incorporate a presumption for a propose-respond model. To facilitate potential efficiencies that could be introduced in the regulatory approach, the Panel recommended that the AEMC be able to develop rules that would be ‘fit for purpose’. In that context, the Panel report envisaged that some provision for propose-respond might be made by AEMC rule-making that would require the regulator, when deciding upon access prices, to give ‘special weight ... to certain elements of the regulated entity’s proposal, or that certain matters be the choice of the regulated entity rather than the AER’.<sup>7</sup>

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<sup>7</sup> Expert Panel on Energy Access Pricing, *Report to the Ministerial Council on Energy*, April 2006, p 87.

The Panel's approach is consistent with the reform principle of transparent regulatory processes (C1), and is reflected in the *Gas Legislative Framework* document, where MCE officials state that the purpose of cl 24(4) is as follows:

... the discretion of the AEMC to make Rules for where **aspects of** a regulatory decision are closer to a 'propose-respond model' has not been limited by the Law.<sup>8</sup>

[emphasis added]

The same document sums up the overall purpose of cl 24 as follows:

This section ensures that the MCE's decision, accepting the Expert Panel's recommendation that a fit-for-purpose model be adopted in the NGL, is not excluded by the text of the NGL.

The approach stated by MCE officials reflects the normal regulatory approach, whereby the service provider is able to nominate its preferred approach to establishing an aspect of an access arrangement, such as the process for adjusting the tariff over an access period. In Chapter 6 of its report, the Expert Panel recommended revenue and pricing principles and methodologies for determining revenues and tariffs. These have been adopted in the draft NGL and NGR.

The Panel Report and the MCE *Gas Legislative Framework* document do not appear to contemplate that a rule could be made with the effect of requiring the regulator to accept or reject a proposal put by a service provider without scope for other options to be discussed and considered for approval.

#### ***Proposals for consideration by MCE SCO***

It is desirable that the policy intent of cl 24(4) be clarified, for instance, in the Explanatory Memorandum, so that it is apparent that it is to be applied consistently with the Expert Panel's recommendations.

## **2. Reconsider the range of options for defining a 'reference service'**

Under the draft NGL, the term 'reference service' now has application only in relation to 'non-light' access regulation.

The principle established in the Gas Code, that a reference service is one that is likely to be sought by a significant part of the market, is understood in the market in the light of 9 years' experience with the Gas Code. In addition, the NGL provides a new, alternative criterion for the service provider to nominate and the AER or ERA to determine a reference service, by having regard to the form of regulation factors (see cl 166(1)(a)(ii)(B)). There is some logic to linking the assessment of which services should be established as reference services to the form of regulation factors making the pipeline fall under full 'non-light' access regulation.

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<sup>8</sup> Standing Committee of Officials of the Ministerial Council on Energy, *2006 Legislative Package: Gas Legislative Framework*, November 2006, p 10.



The view of the AER and ERA is that the provisions in Part 4.3 of the Law for the service provider to nominate and the regulator to determine reference services provide sufficient flexibility and certainty for stakeholders, consistently with reform principle B, of maximising certainty for stakeholders.

Clause 7 provides for a third option, that the Rules may declare or specify a reference service. This will further involve a rule-making body in undertaking essentially regulatory functions; will increase the range of information the AEMC is required to consider as part of its determination; and will require it to broaden its technical skills.

The regulators' view is that established practice under the Gas Code in relation to determining reference services encapsulates the reform principles of adopting the lightest possible regulation (B2) and streamlined process (C2). Regulators would observe and report on the operation in practice of the new form of regulation factors criterion for determining a reference service. The AER and ERA are also of the view that it is sufficient to establish, in the NGL, the criteria for determining a reference service, without providing for rule-making that would involve the AEMC, in effect, in making regulatory assessments of services.

#### ***Proposals for consideration by MCE SCO***

The AER and ERA agree with MCE officials that the established definition of 'reference service' modelled on the Gas Code should be retained in the Law. The AER and ERA propose that the effect in operation of cl 166(1)(a)(ii)(B) be assessed at the next legislation review in the light of the regulators' experience in practice of the operation of the new, alternative, criterion.

The AER and ERA propose that the determination of a reference service not involve rule-making. Accordingly, in cl 7 of the NGL, it is proposed that:

1. paragraph (a) be deleted; and
2. the chapeau to paragraph (b) be amended to read as follows:

that the AER [or ERA] approves or requires to be a reference service in –

### **3. Define the circumstance in which Rules would replace the Law's procedure for deciding a proposed variation to an applicable access arrangement**

The AER and ERA understand that cl 186(3) was included in the NGL as a means of giving effect to MCE policy that proposed new facilities investment be subject to a streamlined consultation process. However, this provision has been drafted in more general terms such that a rule could be drafted to change consultation requirements set out in cll 186(1) and (2) in respect of a proposed variation to an access arrangement.

The regulators understand that the policy objective behind NGL cl 186(3) is achieved by cl 28 ('AER's power to make advance determination with regard to future capital expenditure') and 31 of the draft initial Rules ('Surcharges'). Determinations on proposed

new facilities investment do not, in the regulators' view, require a variation to an access arrangement and so cl 28 and 31 of the Rules adequately serve the policy objective.

Sub-clause 186(3) is open-ended as it now stands and may have consequences that were not expected by policy-makers. That gives potential for conflict with the reform principle of maximising certainty for stakeholders (B).

***Proposal for consideration by MCE SCO***

The AER and ERA propose that rule-making under cl 186(3) of the NGL be restricted to tightly defined circumstances where the intention is to clarify the discretion available to the regulator to carry out consultations in relation to a proposed variation to an access arrangement.

**4. Clarify the operation of certain ring-fencing provisions**

***Possible alternative model for extending the NGL to new forms of 'associate'***

The definition of 'associate' in cl 5 makes provision for regulations to extend the meaning of 'associate' beyond the definition in the Corporations Act.

Such a provision is timely in the light of ACCC and ERA experience that asset management arrangements have been increasingly used in the industry since the Gas Code was developed. In the regulators' view, if that development were not addressed by the Law, such arrangements could impede the effectiveness of the ring-fencing provisions. A concern of this kind arises because the regulator wishes to ensure that regulatory accounts available to it give a complete picture of the managerial arrangements, expenditures and operations involved in delivering services over the covered pipeline. Information of this kind would inform the regulator in determining whether or not any ring-fencing determination is consistent with the national gas objective and the ring-fencing principles in cl 120(3) of the NGL.

Extending the NGL's provisions to entities operating under new forms of arrangement with the service provider involves a balance between the reform principles of providing for transparent regulatory processes (C1) and information-gathering powers sufficient to discharge regulatory functions (C3). The AER and ERA assume that consultation with stakeholders will occur before the regulatory power is extended, consistently with reform principle B3.

As it might only be practical to extend the Law to new types of 'associate' on a case-by-case examination of their circumstances, the process of extending the ring-fencing provisions to new 'associates' of a service provider does not readily lend itself to rule-making. That may have prompted the proposal to use the Regulations. The AER and ERA would need to consider the detail of any regulation if MCE proceeds according to cl 5.

However, regulations would not be the only means to achieve the same regulatory objective and the AER and ERA suggest that other options to provide a more direct and consultative process be considered. The preferred option of the AER and ERA is as follows:

***Proposal for consideration by MCE SCO***

The Law could set out a process whereby the regulator on its own initiative or on application by a user or prospective user could declare an entity to be an associate of a service provider if the following conditions apply:

1. the arrangement between the service provider and entity is not an ‘associate contract’ [as defined in the NGL];
2. the entity supplying services to the service provider contributes materially to the provision of a pipeline service [as defined in the NGL];
3. the regulator is not satisfied that the contractual arrangements between the service provider and the entity supplying services to it were made or operate at arm’s length; and
4. the declaration of the entity as an associate would assist the regulator in carrying out its economic regulatory functions.

A declaration of this kind could be subject to the consultative decision-making model set out in Part 7 of the draft Rules and could be a reviewable regulatory decision for the purposes of cl 272 of the NGL.

***Gas Code provisions for exemption from ring-fencing obligations***

Clause 121 of the NGL provides for the regulator to exempt a service provider from the minimum ring-fencing obligations. Pursuant to the Schedule to the draft initial Rules, the regulator is to follow the consultative decision-making model in Part 7 of the Rules for these decisions. Unlike the Gas Code, the NGL and Rules do not provide criteria, other than to take account of the national gas objective and, appropriate, the revenue and pricing principles.

The Gas Code criteria are consistent with the reform principle of adopting the lightest form of regulation consistent with curbing potential misuse of market power (B2).

***Proposal for consideration by MCE SCO***

The AER and ERA suggest that if there is a requirement for more detailed criteria than the national gas objective, the Gas Code criteria be adopted.

## 5. Provide for prudent discounts and rebatable services

The Gas Code incorporates two specific mechanisms that give incentives for a regulated pipeline to negotiate on price and service levels so as to use capacity more efficiently for the benefit of the service provider and users. Neither of these provisions has been transferred from the Gas Code to the draft NGL or the draft initial Rules.

### Prudent discounts

First, the service provider may negotiate a prudent discount from the reference tariff or equivalent tariff for a non-reference service and, subject to regulatory approval, recover the discount from other users of the reference service (s 8.43).

This first mechanism deals with the threat that the pipeline might be under-used, for instance, should bypass occur. That might increase tariffs for users when volumes on the pipeline fall. Because of concerns that capacity might be under-used if all tariffs were non-discriminatory, the PC in its review of the gas access regime endorsed the prudent discount mechanism in the Gas Code as articulated by the ACCC.<sup>9</sup> However, the PC recommended that the prudent discount provision be deleted as it would be ‘unnecessary’ if its recommendation to delete s 8.42 of the Gas Code, concerning the allocation of costs and revenues between users, i.e., a mechanism to secure cost-reflective pricing, was deleted.<sup>10</sup>

Prudent discounts have been approved for the covered Western Australian gas distribution system. Approximately 3% of revenue is raised by the 30% of the volume of gas delivered on this distribution system via tariffs subject to prudent discounts.<sup>11</sup>

The National Electricity Rules (NER) make provision for prudent discounts in respect of services that are and are not subject to a revenue cap.<sup>12</sup> ACCC/AER guidelines under the Rules contain a test of prudence of the discount.<sup>13</sup>

The rules on pricing of prescribed electricity transmission services are currently under review by the AEMC. In its Report on a proposed revised rule, the AEMC stated that the majority of submissions expressed the view that the Rules should provide scope for the negotiation of

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<sup>9</sup> Productivity Commission, Inquiry Report No 31: *Review of the Gas Access Regime*, Melbourne, 11 June 2004, p 379.

<sup>10</sup> Productivity Commission, Inquiry Report No 31: *Review of the Gas Access Regime*, Melbourne, 11 June 2004, p 263.

<sup>11</sup> Economic Regulation Authority, *Further Final Decision and Final Approval of Proposed Revisions to the Access Arrangement for the Mid-West and South-West Gas Distribution Systems*, 10 August 2005, Tariff Model for ‘Final Approval for AGN’s Second Access Arrangement’, p 1 (<http://www.era.wa.gov.au/library/AGN%5FFFA2%5FPublic%5FRv00%5F00.pdf>); and AlintaGas Networks Pty Limited, *AlintaGas Networks Access Arrangement Information for the Mid-West and South-West Gas Distribution Systems*, amended AAI, 29 July 2005, p 73.

<sup>12</sup> See NER cl 6.5.8 and the definition of ‘negotiable service’ in Ch 10 of the NER.

<sup>13</sup> ACCC, *Guidelines for the Negotiation of Discounted Transmission Charges*, 3 May 2002, pp 1-3.

prudent discounts. The AEMC proposed to elevate the existing guidelines to the Rules, subject to some revisions to promote greater procedural flexibility.<sup>14</sup>

#### **Rebatable services**

The service provider is conditionally permitted to recover, from the reference service of what is now termed a ‘non-light’ access arrangement, costs for a rebatable service (s 8.40). This second mechanism is designed to encourage the development of new services having uncertain demand initially. The Moomba to Adelaide Pipeline System provides an example in which the service provider proposed a rebatable interruptible service as a way of developing the market for haulage services in the face of capacity being tied up by existing long-term firm haulage contracts. This rebate works by a discount from the reference tariff reflecting revenues raised from the rebatable service. Other types of rebatable services are also possible.

#### **Regulators’ views on the need for prudent discounts and rebatable services**

The service provider’s ability under the NGL to discount the price of a service only goes some way to dealing with the threat of underutilisation because it does not incorporate a mechanism for sharing the cost and benefit of the discount amongst users. Similarly, the rebatable service mechanism takes account of revenues from a service whose demand cannot be readily forecast, while allowing users to benefit from improved pipeline utilisation through a lower reference tariff.

It seems to the AER and ERA that a prudent discount mechanism is still useful to establish price differentials from the reference tariff because it gives specific guidance concerning permissible departure from terms of supply to customers of reference or equivalent services, in the interests of the service provider and users generally. That is likely to encourage greater flexibility in pricing than would otherwise occur in respect of non-light regulation pipeline services.

#### ***Proposal for consideration by MCE SCO***

The NGL incorporate provisions for prudent discounts and rebatable services modelled on the Gas Code provisions.

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<sup>14</sup> AEMC, *Transmission Pricing for Prescribed Transmission Services: Rule Proposal Report*, Sydney, 24 August 2004, pp 74, 76.

## **6. Achieve a consistent and clear test for price discrimination**

### *Issue with the proposed NGL price discrimination provisions*

The issue with the approach to price discrimination proposed for the NGL is that the scope of price discrimination that the Law permits is uncertain and potentially may conflict with the ring-fencing principle of not favouring an associate over others.

### *Draft NGL obligations limiting price discrimination*

The NGL Exposure Draft contains two provisions, in similar terms, requiring certain service providers to undertake not to engage in price discrimination unless the discrimination is of a kind permitted by the draft Law. A service provider would be required to undertake not to engage in price discrimination in the supply of pipeline services over:

1. a covered pipeline that becomes subject to a light regulation determination (which exempts it from price and revenue regulation); or
2. an international pipeline that becomes subject to an exemption from price and revenue regulation.

Under the draft NGL, price discrimination by a pipeline does not breach an undertaking if it:

- (a) is conducive to efficient service provision; or
- (b) can be justified on some other rational economic basis.

(See NGL cll 141 and 249(4).)

The NGL obligations on international pipelines appeared in amendments made to the GPAL in September 2006 as a transitional measure pending public consultation on and introduction of the NGL.

The NGL does not contain a limitation against ‘price discrimination’ in the negotiation of terms of access for a non-light regulation pipeline. The service provider and access seeker may negotiate on terms of access. For those pipelines, the reference tariff is a reference point for negotiation, because, in the event of a dispute over access, unless resolution of the dispute requires an access seeker to fund some or all of a new facility, the arbitrator must give effect to the applicable access arrangement, i.e., must apply the reference tariff (NGL cll 206 and 210). These provisions have been carried over from the Gas Code and do not, in the regulators’ view, cause any conflict with achieving the objective of the NGL.

### ***The NGL definitions of permissible price discrimination***

According to the Federal Court of Australia, the meaning of ‘discriminate’, in relation to prices, is to ‘differentiate’ or ‘treat differently those who are alike in a relevant sense’.<sup>15</sup> That meaning is in line with everyday usage.<sup>16</sup>

#### **(a) Potential uncertainty as to the nature and scope of permissible price discrimination**

*‘Conducive to efficiency’*

The terminology in the draft NGL referring to permissible price discrimination that is ‘conducive to efficient service provision’ is a variation on terms adopted in amendments to the national access regime under the *Trade Practices Act 1974*, initially proposed by the PC, to permit ‘multi-part pricing and price discrimination when it aids efficiency’.<sup>17</sup> In its Competition and Infrastructure Reform Agreement, COAG agreed that these principles are to be included in the certification criteria for all access regimes.<sup>18</sup>

The PC generally has interpreted ‘efficient pricing’ in a particular way, i.e., charging according to the value placed on a service by the user rather than according to the cost to the infrastructure facility of providing the service.<sup>19</sup> According to the PC, the former type of pricing is ‘efficient’ in the sense that it allows the facility owner to cover its costs while minimising the ‘loss in efficiency’ that would result from reduced use of the service if the service provider’s market power were constrained by cost-based regulation of its pricing.<sup>20</sup> The prudent discount mechanism (discussed above), which is subject to regulatory oversight, provides a framework for achieving the PC objective but it prevents the service provider from exercising market power.

In *Virgin Blue Airlines Pty Limited*, the Tribunal considered an application to move the pricing of domestic airside services at Sydney Airport from a light-handed monitoring regime to a regulated access regime.<sup>21</sup> In doing so, the Tribunal considered whether the airport’s method of devising charges for airside services discriminated against Virgin Blue in favour of

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<sup>15</sup> *O’Brien Glass Industries Ltd v Cool & Sons Pty Ltd* (1983) ATPR ¶40-376, Franki J, 44,466 and Fox J, 44,458.

<sup>16</sup> The Macquarie Dictionary: *Australia’s National Dictionary Online*, ‘discriminate’, viewed 21 November 2006.

<sup>17</sup> Productivity Commission, Inquiry Report No 17: *Review of the National Access Regime*, Melbourne, September 2001, p 338.

<sup>18</sup> COAG Meeting, Communiqué, Attachment B, Appendix E: *Competition and Infrastructure Reform Agreement*, 10 February 2006, [2.4 b ii]; and see *Trade Practices Act 1974* (Cth), s 44ZZCA(b)(i).

<sup>19</sup> Productivity Commission, Inquiry Report No 17: *Review of the National Access Regime*, Melbourne, September 2001, p 326.

<sup>20</sup> Productivity Commission, Inquiry Report No 17: *Review of the National Access Regime*, Melbourne, September 2001, pp 67, 94, 325-327; and Productivity Commission, Inquiry Report No 31: *Review of the Gas Access Regime*, Melbourne, 11 June 2004, pp 89-90.

<sup>21</sup> *Virgin Blue Airlines Pty Limited* [2005] ACompT 5.

the major airport user, Qantas, and concluded that it did.<sup>22</sup> The Tribunal took into account cost drivers in the airport's operations and found that they were not reflected in the airport's schedule of charges.<sup>23</sup>

The Tribunal commented that a tariff that did not reflect the underlying cost drivers was likely to deter competitive activity in downstream markets and was not conducive to efficient service provision by the monopoly facility owner or to efficient use of the airport.<sup>24</sup> The Tribunal's approach, based on the operational and economic evidence, was consistent with a stated government policy objective referred to by the Tribunal, that returns to the facility owner should reflect the efficient costs of the service provider and provide an adequate return on capital.<sup>25</sup>

Price discrimination devised by a monopoly service provider may not reflect efficient costs or equate to efficient pricing as understood in relation to a competitive market. Price discrimination may be conducive to efficiency if it reflects cost drivers or deals sufficiently with a real threat of underutilisation of capacity and if the facility owner does not have an incentive to limit the number of prospective users in order to enhance its bargaining power with major users. That approach to price discrimination is consistent with the national gas objective and, in particular, with cl 21(2) of the NGL's revenue and pricing principles.

In view of the history of development of the NGL provision on price discrimination, if the NGL contains a provision for price discrimination 'that is conducive to efficiency', it is desirable that stakeholders understand before the Law is enacted how that term would be interpreted. That is, in accordance with ordinary principles of statutory interpretation, it would be interpreted so as to best achieve the purpose or objective of the Law (see NGL Schedule 2 cl 7). Particularly relevant are the national gas objective and the revenue and pricing principles.

*'Some other rational economic basis'*

The origins of the second limb of permissible price discrimination under the draft NGL are not clear. It does not appear in the Gas Code or in the Parer, PC gas access or Expert Panel reports.

The exercise of monopoly power is rational from the perspective of a profit-maximising monopolist, but, for reasons explained above, in other respects potentially wasteful in utilisation of capital investment, detrimental to downstream competition and, potentially, to economic efficiency. The PC pointed out that, in a comparative static model, a business facing low price-responsiveness of demand could price discriminate fully with the result that

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<sup>22</sup> *Virgin Blue Airlines Pty Limited* [2005] ACompT 5, [310], [504].

<sup>23</sup> *Virgin Blue Airlines Pty Limited* [2005] ACompT 5, [504].

<sup>24</sup> *Virgin Blue Airlines Pty Limited* [2005] ACompT 5, [235]-[238].

<sup>25</sup> *Virgin Blue Airlines Pty Limited* [2005] ACompT 5, [38], [504].



it ‘would earn excess profits at the expense of consumers, but with no loss in economic efficiency’.<sup>26</sup>

Even if the new provision is to be interpreted from a wider economic perspective than that of the service provider or a user and to embrace such things as capacity utilisation, there are remaining concerns.

Objectives consistent with overall economic efficiency fall within the first test of permissible price discrimination, as ‘conducive to efficiency’, anyway. The second limb of permissible price discrimination – ‘some other rational economic basis’ – is a departure in terminology from the national gas objective. Interpreting it would involve a search through economic literature and case law, resolution or rejection of the opinions of economic experts and a greater emphasis on case-by-case analysis than if terminology that is consistent with the national gas objective were applied. The resulting uncertainty may reduce service providers’ incentive to negotiate efficient price differentials and/or result in unnecessary disputation.

**(b) Potential conflict with ring-fencing principle of not favouring an associate over others**

Sub-clauses 120(3) and 124(2) of the draft NGL reflect a Gas Code principle that, in acquiring pipeline services, associates of the service provider should not benefit from their relationship with the service provider in a way that other users and prospective users could not enjoy.<sup>27</sup> Paragraph 120(3) expresses the principle in the following way:

a service provider must ensure that the service provider provides pipeline services to its associates as if the pipeline services being provided by the service provider are being provided to an entity different from, and unrelated to, the service provider.

If the limits of permissible price discrimination are vague, a service provider might defend terms favouring an associate by comparison with other users accessing services at the reference tariff by arguing that it was permissible price discrimination.

The Law needs to clearly establish the scope of permitted price discrimination for associate contracts.

***Summary of concerns with the draft NGL price discrimination provisions***

The foregoing discussion suggests that the price discrimination provisions for light regulation and international (price-regulation exempt) pipelines as drafted are uncertain in scope and in conflict with the reform principle (B) of maximising certainty for stakeholders.

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<sup>26</sup> Productivity Commission, Inquiry Report No 31: *Review of the Gas Access Regime*, Melbourne, 11 June 2004, p 89.

<sup>27</sup> See Gas Code, s 4.3(a).

***Proposals for consideration by MCE SCO***

To address those concerns, it is proposed that:

1. the exception from price discrimination for discrimination that ‘can be justified on some other rational economic basis’ be deleted;
2. the Explanatory Memorandum for the NGL make clear that ‘efficiency’, where referred to in the price discrimination provisions, is to be interpreted in accordance with the usual principles of statutory interpretation, the national gas objective and revenue and pricing principles being particularly relevant; and
3. the Law clearly establish the scope of permitted price discrimination for associate contracts, e.g., that terms for an associate contract be no more favourable than the terms of contracts with other users.

## **7. Clarify certain information-management issues**

### ***Regulatory recourse to assumptions under cll 170(3)(c) and 178(3)***

Clauses 170 and 178 provide that, in assessing an access arrangement, the regulator may make reasonable assumptions about any matter on which the service provider has made an assumption or has not met the regulator’s requirement to provide information.

The AER and ERA understand the purpose of this provision is to enable the regulator to adopt reasonable counter-assumptions to those of a service provider if the regulator is not satisfied with the basis for the service provider’s assumptions. Examples where this would be relevant would be:

- an estimate of the expected useful life of a pipeline on the basis of assumptions adopted by the service provider about the likely life of the main gasfield supplying pipeline users; or
- an estimate of pipeline life based on assumptions about the rate of cracking of the pipeline if a particular maintenance regime is followed.

In both the examples cited, in accordance with reform principle B3 (prior consultation with relevant stakeholders) the regulator’s initial approach should be to determine whether or not information is available from the service provider or other sources (such as a consultancy) to support the service provider’s assumptions. The AER and ERA do not envisage that the regulator would go straight from the service provider’s assumption to an assumption of its own, or a counter-assumption, without further inquiry. However, it is consistent with reform principles C2 (streamlined process and timeframes) and C3 (information-gathering powers sufficient to discharge regulatory functions) for the NGL to confirm that the regulator may make reasonable assumptions or counter-assumptions in response to the service provider’s assumptions.

***Proposal for consideration by MCE SCO***

The regulators suggest that the policy intent of the relevant provisions could be clarified by inserting the words ‘following reasonable inquiries of the service provider or other relevant sources of information,’ before the words ‘make reasonable assumptions’ in cll 170(3)(c) and 178(3).

**8. Clarify the regulatory approach to late submission of substantially new issues**

The NGL Exposure Draft reproduces Gas Code provisions that permit the service provider, in response to the regulator’s draft decision on a proposed access arrangement, to submit revisions that ‘incorporate or substantially incorporate’ revisions specified by the regulator or ‘otherwise address’ the regulator’s requirements (see cll 170(5)(b), 173 and 178(5)). Based on the experience of the ACCC and the AER with the Gas Code, the ‘otherwise address’ element gives latitude to a service provider to raise new issues, or substantially update information, late in the assessment process.

Several provisions give the regulator some scope to assess late revisions, i.e.:

- to extend the period of time for submissions on material revisions to an access arrangement (cl 175);
- limited clock-stopping to seek further information (cl 179); or
- limited extension of the assessment period (cl 359(2)).

However, should the scope of proposed revisions be such as to raise substantially new issues that could not reasonably be assessed in this way, the regulator might need to inform the service provider that it would regard the revisions as a new proposal for an access arrangement, not falling within the scope of the existing application for approval.

That approach should not create insurmountable problems for users and service providers where an existing access arrangement would continue to operate during the assessment period pursuant to cl 188(1). However, if the regulator was considering an access arrangement under a new application that departed from an existing access arrangement in relation to the services provided under it, even if only in relation to a minor service, the present draft cl 188(1) would not keep the existing access arrangement effective past its expiry date.

That is because cl 188(1) of the draft NGL is worded in such a way as to provide that if another access arrangement is submitted for approval in relation to ‘the same pipeline services as those to which the applicable access arrangement applies’, before the latter arrangement expires, the existing access arrangement does not expire. It seems to the AER and ERA that if the replacement access arrangement incorporated some variation in services proposed to be provided, the earlier access arrangement would not attract the benefit of cl 188(1).

So as to avoid any discontinuity in access arrangements, the AER and ERA envisage that, if there was not an existing access arrangement or an existing arrangement would not continue

to operate throughout the assessment period, the regulator would exercise its powers under Division 3 of Part 4.3 of the NGL Exposure Draft to make an access arrangement itself.

***Proposal for consideration by MCE SCO***

To provide for the continuing operation of an access arrangement while a revised access arrangement referring to different services is under assessment or review, the AER and ERA propose that cl 188(1) be amended by replacing the words ‘the same pipeline services as those’ with the following:

... pipeline services over the same pipeline as that ...

**9. Enhance clock-stopping to recognise parallel regulatory procedures**

A number of covered pipeline service providers that have current approved access arrangements may apply to the AEMC for a determination of light access regulation. If such an application coincided with the review period for lodging and assessing a replacement access arrangement, the NGL would still oblige the service provider to lodge, and the regulator to carry on assessing, a replacement arrangement. That would cause wasted effort to the service provider and the regulator, and would be inconsistent with reform principles B3, that the lightest effective form of regulation would be available, and C2, that administration of the Law would be streamlined.

***Proposals for consideration by MCE SCO***

A solution would be to extend the grounds in cl 179 for clock-stopping so that it applied not only during judicial review of an application but also where the coverage or form of regulation of the pipeline was under review by another decision-maker and the access arrangement had a continuing operation.

So that users and prospective users were not left without a framework for access in the meantime, in the regulators’ view the clock should stop *only if* an existing access arrangement was in place and would continue to operate while an application for revocation of coverage or for light regulation was being considered by the other decision-maker.

While it was the case under the Gas Code that access arrangements would continue indefinitely, subject to periodic submission of revisions for regulatory approval, under the NGL access arrangements have a finite term (see cll 157 and 158), unless replaced by another access arrangement before the expiry date (cl 188).

Therefore, the AER and ERA also propose that cl 188(2) be amended to provide that the existing access arrangement continue in effect pending the determination of an application for revocation of coverage or for light regulation.

## **10. Amend the unusual presumption that, if the Tribunal awards costs in a merits review, the order for costs be on an indemnity basis**

The draft NGL creates a strong presumption that, if costs are awarded against a party to a merits review, the award is to be on an indemnity basis – see cl 290 and 291. That means that if costs are awarded against a party, the party is liable for its own costs and the costs of each party benefiting from the order, i.e., in customary legal usage:

All costs, including fees, charges, disbursements, expenses and remuneration recoverable incurred by a party to litigation in undertaking proceedings, provided they have not been unreasonably incurred or are not of an unreasonable amount. ...<sup>28</sup>

Once it decided to award costs, the Tribunal's discretion to award costs on any customary lesser basis, e.g., party and party costs, would be severely limited by the NGL – the Tribunal would have to fix the amount on an indemnity basis unless there were 'exceptional circumstances' (see cl 291(1)).

The GPAL and Gas Code do not create a presumption of this kind.

Indemnity costs are usually reserved for the most serious misconduct by a party to a proceeding and may have implications for the party's reputation. Normally, an order for costs on an indemnity basis would not be made by a court unless 'some feature of the litigation' persuaded the court that a special order of costs should be made.

Instances described in the High Court in which this might occur would be where the party's conduct is:

... 'plainly unreasonable', pursued for 'an ulterior or collateral purpose', undertaken in an 'unmeritorious, deliberate or high-handed' way or where that opponent has been shown to be guilty of 'unreasonable conduct, albeit that it need not rise as high as vexation'.<sup>29</sup>

However, misconduct or lack of merit 'is not strictly necessary ... as indemnity costs may be awarded, for example, where the proceedings are a test case brought in the public interest' and the other party has refused a reasonable offer of settlement.<sup>30</sup>

Creating a presumption in favour of indemnity costs would reverse these usual principles.

### ***Impact of the draft provision***

Clause 283 of the NGL Exposure Draft defines a 'party' to a merits review under Part 6.5 of the NGL as the applicant, the original decision-maker and an intervener.

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<sup>28</sup> LexisNexis, *Encyclopaedic Australian Dictionary*, 'Indemnity costs', viewed 9 November 2006.

<sup>29</sup> *Ruhani v Director of Police* [2005] HCA 42, Kirby J, [243], citing a number of decisions of superior courts.

<sup>30</sup> LexisNexis, *Encyclopaedic Australian Dictionary*, 'Indemnity costs', viewed 9 November 2006; *Baltic Shipping Co v Dillon (The Mikhail Lermontov)* (1991) 22 NSWLR 1, Kirby P, 34-35; and *Australian Federation of Consumer Organisations Inc v Tobacco Institute of Australia Ltd* (1991) 100 ALR 568.

The ‘applicant’ is defined by cll 272 and 273(1) as being a person who is granted leave to apply to the Tribunal for a review. A range of service provider and user interests and other persons whose interests are affected by a decision can be an ‘applicant’ for a review.

The NGL explanatory documentation states that there ‘will be a relatively wide scope for persons and groups to intervene in merits review proceedings, once commenced’. The relevant paper continues:

Persons with a sufficient interest in the decision are able to intervene, as well as jurisdictions, and user and consumer associations and interest groups with leave of the ACT [Australian Competition Tribunal].<sup>31</sup>

A service provider has an incentive to appeal if the potential revenue rewards are significantly greater than the potential costs of appeal, which would usually be the case, notwithstanding the possibility of an adverse award of costs. However, contrary to the stated policy intention favouring a wide scope for involvement of interested parties, the presumption of indemnity costs may deter such involvement in Tribunal proceedings. For those parties, it is less likely that the potential rewards of intervention would outweigh the potential costs. This lack of balance in the effect of cl 291 potentially puts it in conflict with the reform principle that regulatory processes be transparent (C1).

In the regulators’ view, cl 291 is also an unnecessary provision. Clauses 274-277 and 280-281 give protection against unmeritorious applications to initiate or intervene in merits review of a regulatory decision. The *Legal Services Directions* (Cth) require Federal decision-makers to act as model litigants and to use their best endeavours to assist the relevant tribunal to make its decision.

Common law practice in awarding costs appropriately punishes contumelious conduct in the course of a proceeding and may assist community organisations acting reasonably and for a purpose that is in the public interest. A court’s discretion to award costs is subject to a ‘guiding principle’ that, subject to any Act to the contrary:

... the general discretion is absolute and unfettered, except that it must be exercised judicially, not arbitrarily or capriciously, and that it cannot be exercised on grounds unconnected with the litigation.<sup>32</sup>

It is likely that presidential members of the Tribunal (who are Judges of the Federal Court) would follow that general principle should the Tribunal exercise a discretion to award costs. Requiring that costs be awarded on an indemnity basis is not consistent with common law practice and appears to conflict with the reform principle (B) that the regulatory scheme maximise certainty and minimise compliance costs of regulation for stakeholders.

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<sup>31</sup> Standing Committee of Officials of the Ministerial Council on Energy, *2006 Legislative Package: Gas Legislative Framework*, November 2006, p 30.

<sup>32</sup> *Australian Federation of Consumer Organisations Inc v Tobacco Institute of Australia Ltd* (1991) 100 ALR 568, 569, citing *Donald Campbell & Co v Pollack* [1927] AC 732.

***Proposals for consideration by MCE SCO***

For the above reasons, the AER and ERA propose that cl 291 be deleted from the NGL or that it be rephrased to state that the Tribunal may award costs at its discretion on a variety of bases, including indemnity costs.

**Australian Energy Regulator**

**Economic Regulation Authority**

19 December 2006