

Rule Change Request: Recommendations from the AEMC’s Final Report: Review into the scope of economic regulation applied to covered pipelines (Part 8-12 review) final report

NAME AND ADDRESS OF RULE CHANGE PROPONENT

Council of Australian Governments (COAG) Energy Council
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DESCRIPTION OF PROPOSED RULE

This rule change request seeks to amend Parts 8-12 of the National Gas Rules (NGR) in order to make improvements that will assist pipeline users and prospective users negotiate lower prices and better terms for their gas transportation agreements.

This rule change request is based on the recommendations contained in Package 1 of the AEMC’s review of economic regulation applied to covered pipelines. The rule change request covers:

- Updating extension and expansion requirements (AEMC recommendations 2 & 4)
- Describing reference and pipeline services and introducing a reference service setting process (AEMC recommendations 5 to 8)
- Improvements to the access arrangement process (AEMC recommendations 9 to 14)
- Clarifying provisions relating to the calculation of efficient costs (AEMC recommendations 15 to 20)
 - The rule change request excludes the calculation of an initial capital base for light regulation pipelines (AEMC recommendation 17) (discussed further below).
- Information provision by service providers (AEMC recommendations 21 to 26)

The proposed rules relevant to this Package 1 are set out at Appendix A.

The AEMC’s recommendations and the Energy Council’s proposed amendments to the NGR are set out in table 1.

Table 1: AEMC’s recommendations and the Energy Council’s proposed rule changes

| AEMC’s recommendations | Proposed amendments to the NGR |
|---|---|
| Package 1 NGR amendments | |
| Include all new expansions in an access arrangement (recommendation 2) | Amendments to rule 104. |
| Enable existing extensions to be included in access arrangements (recommendation 4) | Amendments to rule 104 and any other changes necessary to provide a mechanism by which a capital base can be determined for any existing extension or expansion which a service provider wishes to include in the access arrangement. |

| AEMC's recommendations | Proposed amendments to the NGR |
|---|---|
| Clarify the requirements for describing pipeline services (recommendation 5) | Insertion of new rule 47A and amendments to rule 45. |
| Clarify the requirements for describing reference services (recommendation 6) | Insertion of new rule 47A, amendments to rule 48 and omission of rule 101. |
| Update the test for determining a reference service (recommendation 7) | Insertion of new rule 47A, amendments to rule 48 and omission of rule 101. |
| Introduce a reference service proposal process and improve the access arrangement review process (recommendation 8) | Insertion of new rule 47A, the omission of rules 13 and 57 and the amendments to rules 41, 50, 59 and 62. |
| Develop financial models to be used by service providers (recommendation 9) | Insertion of new rules 75A and 75B. |
| Clarify the operation of revenue caps (recommendation 10) | Amendment to rule 92. |
| Clarify that the regulator is to have regard to risk sharing arrangements (recommendation 11) | Amendments to rules 97 and 100. |
| Extend the revision period (recommendation 12) | Amendment to rule 59. |
| Clarify the process for equalising revenue during the interval of delay (recommendation 13) | Amendments to rules 3 and 92. |
| Remove the limited and no discretion regulatory framework (recommendation 14) | Omission of rule 40 and amendments to rules 41, 50, 79, 89, 91, 94 and 95. |
| Provide guidance on the allowed return for speculative capital expenditure (recommendation 15) | Amendments to rule 84. |
| Clarify the application of the new capital expenditure criteria (recommendation 16) | Amendments to rule 79. |
| Enable addition of existing extensions and expansions to the opening capital base (recommendation 18) | Amendment to rule 77. |
| Require allocation of expenditure between covered and uncovered parts of a pipeline (recommendation 19) | Amendments to rules 79 and 91. |
| Amend definition of rebateable services and rebate methodology (recommendation 20) | Amendments to rule 93 and 97. |
| Require transmission pipeline service providers to disclose Bulletin Board information (recommendation 21) | Omission of rule 111 and amendments to rules 141, 145, 177. |
| Require distribution pipeline service providers to disclose capacity and usage information (recommendation 22) | Proposed rules 35B, 36A to 36C in Part 7, 112A, 112B, 112C and 112D in Division 2 of Part 11. |
| Clarify the role of the regulator in passing on information requests to service providers (recommendation 23) | Amendments to rule 107. |
| Introduce a financial and offer information disclosure regime for light regulation pipelines (recommendation 24) | Proposed rules 35B, 36A, 36D to 36F, in Division 2 of Part 11 and amendments to rule 36. |
| Remove the requirement to provide KPIs as part of the access arrangement (recommendation 25) | Amendments to rules 45 and 72. |
| Improve the Scheme Register (recommendation 26) | Amendments to rules 133 to 135 and insertion of new rule 135A. |

STATEMENT OF ISSUES, PROPOSED SOLUTIONS AND PROPOSED RULE CHANGES

Background

In 2016, the COAG Energy Council published its gas market reform package. The package was developed in response to the 2016 reports into the east coast gas markets by the Australian

Consumer & Competition Commission ¹ and the AEMC ². Both reports found that improvements to the regulatory framework for gas transportation were required in order to:

- prevent the opportunity for monopolistic behavior and pricing;
- improve the function of the gas transportation market;
- achieve the Energy Council’s gas market vision;
“The Council’s vision is for the establishment of a liquid wholesale gas market that provides market signals for investment and supply, where responses to those signals are facilitated by a supportive investment and regulatory environment, where trade is focused at a point that best serves the needs of participants, where an efficient reference price is established, and producers, consumers and trading markets are connected to infrastructure that enables participants the opportunity to readily trade between locations and arbitrage trading opportunities.”³

As part of the package of reforms, the COAG Energy Council requested that the AEMC review the economic regulatory framework as it currently applies to covered transmission and distribution natural gas pipelines across Australia. The terms of reference asked the AEMC to:

“make recommendations on any amendments it considers necessary to Part 8-12 of the NGR to address concerns that pipelines subject to full regulation are able to exercise market power to the detriment of economic efficiency and the long term interests of consumers.”

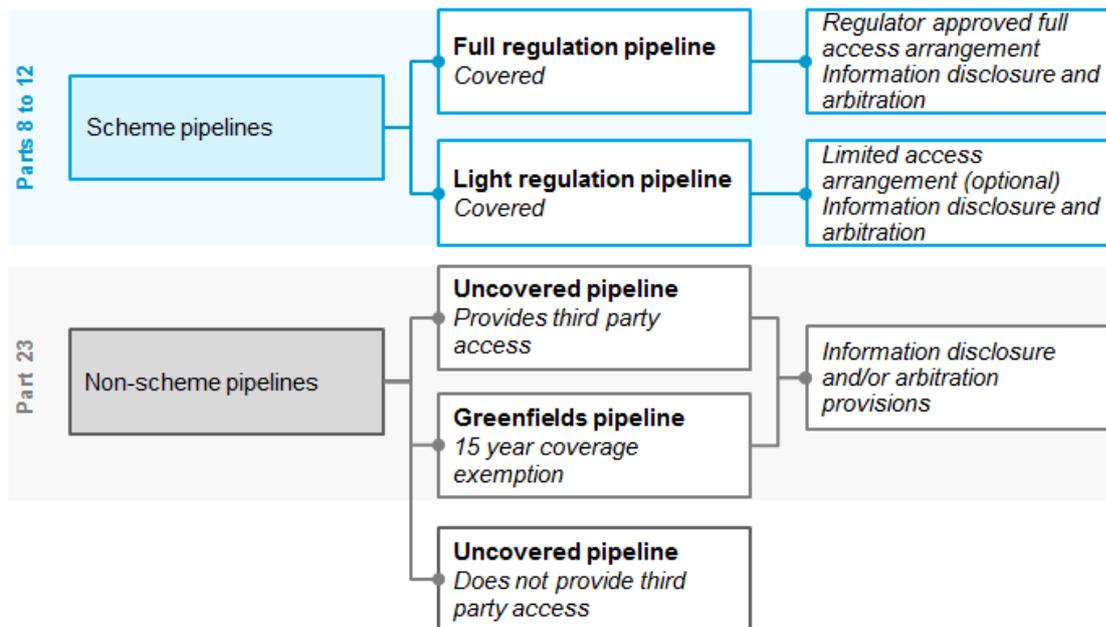
The regulatory framework applied to covered pipelines is incentive-based, with an underlying reliance on the use of negotiation and arbitration. Pipeline service providers and prospective users negotiate the tariff and non-tariff terms and conditions for access to pipeline services provided by covered pipelines. These negotiations are informed by access arrangements for full regulation pipelines and published pipeline information (for light regulation pipelines, or uncovered pipelines regulated by Part 23 of the NGR). The different key classifications of pipelines and the relevant regulatory regimes are illustrated in Figure 1 below.

Figure 1 Overview of pipeline classification

¹ ACCC, Inquiry into the east coast gas market, April 2016.

² AEMC, East coast wholesale gas market and pipeline framework review, Stage 2, Final report, May 2016.

³ COAG Energy Council, Australian gas market vision, December 2014.



This framework recognises the importance of contractual negotiations, specifically in relation to the provision of pipeline services.

The AEMC found that the negotiate-arbitrate framework remains appropriate and should be preserved. The AEMC also found that pipelines have characteristics which can confer monopoly power on the owner of the pipeline. Consequently, the AEMC also found the benefits of contractual negotiations must be balanced against the need to constrain the exercise of market power of pipeline service providers in order to protect the interests of users, prospective users and ultimately the consumers of gas.

The AEMC made a range of recommendations to improve the operation of gas pipeline regulation. This rule change request seeks to address issues within the framework in relation to:

- Expansions and extensions
- Reference services
- Access arrangements
- Determining efficient costs
- Negotiation and information

Extensions and expansions

In its review, the AEMC found the regulatory framework for extensions and expansions⁴ currently depends on the form of regulation that applies to the original pipeline that is being extended or expanded. The NGR require a full access arrangement and a limited access arrangement for a light regulation pipeline to include extension and expansion requirements. These requirements provide discretion over the regulatory treatment of expansions and this discretion has resulted in inconsistent treatment over time. For example, it was noted that 46 per cent of the capacity of the Goldfields Gas Pipeline is uncovered, despite the original pipeline being covered.

The AEMC found that where an expansion to a covered pipeline is outside the access arrangement, service providers may have opportunity to exert monopoly power over both the uncovered and covered parts of the pipeline. The AEMC recommended amendments to the NGR to enable consistent treatment of both original pipeline and the expansion would prevent the service

⁴ Expansions of gas pipelines are augmentations of capacity (the addition of compressors or looping), while extensions increase the geographic footprint of the pipeline.

providers from monopolistic pricing over the expansions, which is in the long term interest of consumers.

The review also found that including expansions in access arrangements would remove some regulatory costs and complexity that arise from having parts of the same pipeline subject to different regulatory requirements (that is, preparing an access arrangement for the original pipeline and complying with Part 23 information obligations for the uncovered expansion).

In relation to extensions, the AEMC found that extensions should continue to be treated on a case by case basis, as they may, for example, constitute laterals that face sufficiently different market landscapes from the covered pipelines themselves. This promotes efficiency in balancing the cost and benefit of regulation in each case.

The AEMC's recommendations and the Energy Council's proposed rules are outlined below.

Extensions and expansions: AEMC recommendations and COAG Energy Council rule change request

Recommendation 2: Include all expansions in an access arrangement

Amend the NGL and NGR such that:

- any future expansions of a covered pipeline be treated as part of the relevant covered pipeline and included in the access arrangement
- an existing expansion of a covered pipeline that is not included in the existing access arrangement must be included in the relevant access arrangement at the next access arrangement revision.

This recommendation is reflected in the proposed amendments to rule 104. However, the proposed amendment relating to the inclusion of existing expansions in access arrangements requires a change to be made to section 18 and 19 of the NGL before it can be implemented so is part of package 2 of the reforms proposed by the AEMC.^(a)

Recommendation 4: Enable existing extensions to be included in access arrangements

Amend the NGR to permit a service provider to seek an existing extension to a scheme pipeline be included in the relevant access arrangement.

This recommendation is reflected in the proposed amendments to rule 104.

Note: (a) This rule change request applies to future expansions only. In addition, the AEMC also recommended that the regulator's discretion to exclude an expansion from light regulation pipelines be removed (recommendation 3). The implementation of this recommendation will require legislative change and is not part of this rule change request.

Reference services

Full access arrangements are the defining feature of the economic regulatory framework for full regulation pipelines under the NGL and NGR. Tariff and non-tariff terms and conditions of access to all services on full regulation pipelines are regulated by reference to reference services. As a result, the reference services included in an access arrangement are the key to the success in applying economic regulation to the services of the pipeline.

Determination of reference services

In the review, the AEMC found that the inclusion of additional reference services in an access arrangement may limit a service provider's use of its market power by assisting users and prospective users in negotiation and arbitration. It also noted that determining an appropriate set of reference services is a trade-off between:

- The benefits that reference services provide to prospective users
- The cost and regulatory burden of the ex-ante determination of reference services and corresponding reference tariff and non-tariff terms and conditions

However, the AEMC found that the NGR are not worded with sufficient clarity to guide the regulator in making the cost-benefit trade-off when determining the number and type of reference services. Consequently, the AEMC recommended that the test for specifying pipeline services as reference services be changed so that the regulator would have regard to a number of factors in order to determine reference services.

The AEMC also found that there are a number of ambiguities in the definition of pipeline services, reference services and the intent of related provisions and recommended changes to the NGR in order to address these.

The AEMC’s recommendations and the Energy Council’s proposed rules are outlined below.

Reference services determination: AEMC recommendations and COAG Energy Council rule change request

AEMC recommendation 5: Clarify the requirements for describing pipeline services

Introduce a requirement to describe pipeline services in an access arrangement such that:

- a pipeline service is to be stated or identified in terms of parameters including type, location and priority (firmness of service), consistent with the provisions for the distinction between pipeline services under rule 549(3) of the NGR for non-scheme pipelines
- the service provider of a covered pipeline is to provide, as part of an access arrangement proposal, a full list of available pipeline services. This list of pipeline services can be referenced to existing gas transportation agreements for that pipeline.

This recommendation is reflected in the proposed new rule 47A and amendments to rule 45 of the NGR.

AEMC recommendation 6: Clarify the requirements for describing a reference service

Specify that the reference service proposal must be drawn from the list of pipeline services and must be described having regard to the reference service factors.

This recommendation is reflected in the proposed new rule 47A and the proposed amendments to rule 48 and the proposed omission of rule 101.

AEMC recommendation 7: Update the test for determining a reference service

Require the regulator to determine one or more pipeline services to be reference services, having regard to the following factors:

- actual and forecast demand for the pipeline service and the number of prospective users of the service
- the extent to which the service is substitutable with other pipeline services
- the feasibility of allocating costs to the pipeline service
- the usefulness of specifying the service as a reference service in supporting access negotiations and dispute resolution for other pipeline services, by providing a point of reference or benchmark for:
 - negotiating access
 - tariffs
 - terms and conditions
- the likely regulatory cost for all parties in specifying the pipeline service as a reference service.

This recommendation is reflected in the proposed new rule 47A and the proposed

amendments to rule 48 and the proposed omission of rule 101.

Reference service process

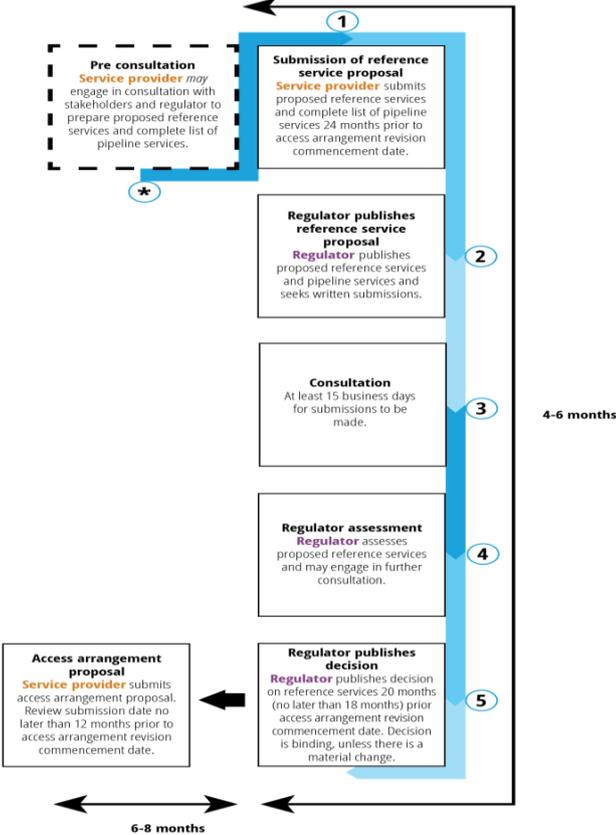
The AEMC found that the current access arrangement process does not provide sufficient time to consider, consult on and determine reference services. As a result, it recommended the introduction of a new reference service setting process.

The new process is expected to improve the prospect of the regulator determining the appropriate number and type of reference services in response to a service provider's proposal. It will also better enable pipeline users (who are the users of reference services) and other stakeholders to engage with and inform the reference service setting process.

The key features of the new process are shown in figure 2 and include:

- The service provider will be required to submit to the regulator a full list of pipeline services and proposed reference services, based on the reference criteria.
- The process will be approximately six calendar months, with at least one round of consultation
- The regulator's final decision on the reference services is guided by the reference service criteria and is binding on the access arrangement process, unless there is a material change in circumstances.

Figure 2: Reference service process



The AEMC’s recommendations and the Energy Council’s proposed rules are outlined below.

Reference services process: AEMC recommendations and COAG Energy Council rule change request

Recommendation 8: Introduce a reference service proposal process and improve the access arrangement review process

Amend the NGR in order to:

- introduce a fit for purpose process to determine the reference services to be provided by the service provider with the following key design elements:
 - the service provider submits to the regulator its full list of pipeline services and proposed reference services, having regard to the reference service factors to be specified in the NGR (recommendation 7)
 - in the event that the service provider fails to submit the list of pipeline services and reference service proposal by 11 months prior to the review submission date, the regulator will propose reference service(s) for that pipeline and commence consultation
 - in the event that the service provider submits a deficient list of pipeline services and reference service proposal, the regulator will set a date for resubmission of the reference proposal
 - the process for the making of the reference service proposal decision will be approximately six calendar months, with at least one round of consultation
 - the regulator's final decision on the reference services is guided by the reference service factors and must be reflected in the access arrangement, unless there is a material change in circumstances that necessitates a change, having regard to the reference service factors
 - in the event the regulator refuses to approve the service provider's reference service proposal, the regulator may make or revise a reference service proposal and make a final decision on that proposal
- enable service providers to set a review submission date and revision commencement date, with the approval of the regulator (rule 50 of the NGR)
- remove the pre-submission conference (rule 57 of the NGR)
- require the regulator to make a final decision on the access arrangement proposal within eight months of receipt of the proposal, with an absolute overall time limit of 10 months between the date that the service provider submits a full access arrangement proposal and the date that the regulator makes a final decision (rules 62 and 62 of the NGR).

This recommendation is reflected in the proposed new rule 47A, the omission of rules 13 and 57 and the amendments to rules 41, 50, 59 and 62.

Access arrangements

All full regulation pipelines are required to have a full access arrangement which sets out reference tariff and non-tariff terms and conditions for each reference service on that pipeline.

As noted by the AEMC, stakeholders have significant concerns in relation to key elements of the full access arrangement process including: tariff setting (including aspects of the tariff variation mechanism); the allocation of risk in non-tariff terms and conditions; the process for reviewing access arrangements; the process for equalising revenue during any interval of delay between access arrangement periods; and the regulatory discretion framework.

The AEMC identified opportunities to amend the NGR in order to provide clarity and certainty around these key aspects of the access arrangement process in order to reduce regulatory and administrative burden and facilitate better outcomes for pipeline users, and ultimately gas consumers.

The AEMC's recommendations and the Energy Council's proposed rules are outlined below.

Access arrangements: AEMC recommendations and COAG Energy Council rule change request

AEMC recommendation 9: Develop financial models to be used by service providers

Allow the regulators to develop and publish financial models that are consistent with Part 9 of the NGR and revenue and pricing principles. If the models are developed and published, service providers will be required to use them to construct the capital base, and the total expected revenue from the building block approach as set out in Part 9 of the NGR.

These models must be developed (and in future, modified or replaced) and published in line with consultation procedures set out in new rule 75A.

This recommendation is reflected in the proposed new rules 75A and 75B.

AEMC recommendation 10: Clarify the operation of revenue caps

Clarify that where the use of a variable revenue cap or a revenue yield control tariff variation mechanism is included in an access arrangement, the mechanism must also provide for any over or under recovery of the revenue cap or yield in the last year of one access arrangement period to be included in the tariff variation mechanism in the following access arrangement period.

This recommendation is reflected in the proposed amendments to rule 92.

AEMC recommendation 11: Clarify that the regulator is to have regard to risk sharing arrangements

Clarify that the regulator is to have regard to the risk sharing arrangements implicit in the access arrangements when determining:

- the non-tariff terms and conditions
- the reference tariff variation mechanism.

This recommendation is reflected in the proposed amendments to rules 97 and 100.

AEMC recommendation 12: Extend the revision period

Extend the revision period from at least 15 business days to at least 30 business days.

This recommendation is reflected in the proposed amendments to rule 59.

AEMC recommendation 13: Clarify the process for equalising revenue during the interval of delay

Clarify that:

- the process for equalising revenue during an interval of delay is to result in a service provider being no better or worse off as a result of the interval of delay
- the definition of the access arrangement period includes the period known as the interval of delay.

This recommendation is reflected in the proposed amendments to the definition of access arrangement period in rule 3 and amendments to rule 92.

AEMC recommendation 14: Remove the limited and no discretion regulatory framework

Remove the limited discretion and no discretion framework from the NGR.

This recommendation is reflected in the proposed omission of rule 40 (as well as proposed amendments to rules 41, 50, 79, 89, 91, 94 and 95).

Determining efficient costs

The accurate determination of efficient costs is fundamental to the setting of efficient reference tariffs. Efficient, cost reflective reference tariffs are required to enable the efficient use and provision of reference services as well as efficient investment in the pipeline.

The AEMC identified a number of issues that relate to the determination of efficient costs for full regulation pipelines. These issues relate to the assessment of capital and operating expenditure, the determination of the capital base, including the application and meaning of depreciation in this context. The AEMC also identified concerns regarding the operation of the cost allocation and rebateable services rules.

The AEMC made recommendations to clarify the provisions of the NGR in order to support the regulator in making decisions that promote the NGO on these elements of an access arrangement proposal. In particular, these decisions will impact on the calculation of reference tariffs which will in turn improve user decision on their use of, and investment in, gas services.

The AEMC's recommendations and the Energy Council's proposed rules are outlined below.

Determining efficient costs: AEMC recommendations and COAG Energy Council rule change request

AEMC recommendation 15: Provide guidance on the allowed return for speculative capital expenditure

Clarify that the rate of return to be applied to speculative capital expenditure is, at a minimum, the return implicit in the reference tariff but that this could be adjusted upwards if the regulator deemed it was appropriate having regard to the circumstances of the particular investment.

This recommendation is reflected in the proposed amendments to rule 84.

AEMC recommendation 16: Clarify the application of the new capital expenditure criteria

Insert the word "and" in rule 79 between subrules 79(1)(a) and 79(1)(b) to make it clear that regardless of which subrule (2) criteria are relevant for the purposes of subrule 79(1)(b), the expenditure in question must also meet the prudency criterion under rule 79(1)(a).

This recommendation is reflected in the proposed amendments to rule 79(1).

AEMC recommendation 18: Enable addition of existing extensions and expansions to the opening capital base

Apply the initial opening capital base determination methodology in rule 77(1) to:

- calculate the initial capital base that is associated with existing extensions and expansions
- roll the existing extensions and expansions forward in the capital base for the pipeline.

AEMC recommendation 19: Require allocation of expenditure between covered and uncovered parts of a pipeline

Amend the NGR in order to:

- require an access arrangement revision proposal to include proposed forecast capital and operating expenditures that refer to costs after an allocation of expenditure between the covered and uncovered parts of a covered pipeline
- require a service provider to provide to the regulator details of the basis and methodology used to calculate the proposed forecast capital expenditure and operating expenditure and the allocation of the expenditure
- clarify the regulator's discretion in assessing the total expenditure and cost allocation.

This recommendation is reflected in the proposed amendments to rules 79 and 91.

AEMC recommendation 20: Amend the definition of rebateable services and rebate methodology

Amend the NGR to:

- enable the reduction of reference tariffs in accordance with rebateable service revenue through the reference tariff variation mechanism
- remove the requirement that rebateable services must be in a different market to reference services.

This recommendation is reflected in the proposed rules 93 and 97.

Negotiation and information

The AEMC found that up to date capacity and usage information is required by prospective users in order to decide whether to seek access and in negotiations for access. Bulletin Board pipeline service providers are required to publicly disclose up to date capacity and usage information. However, the up to date disclosure obligations on other full and light regulation pipeline service providers are limited, meaning that prospective users may be insufficiently informed in their access negotiations.

To address these issues, the AEMC recommended that:

- covered transmission pipeline service providers be required to disclose augmented Bulletin Board information
- covered distribution pipeline service providers be required to disclose capacity and usage information.

The AEMC also found that light regulation pipeline service providers are required to publish very little financial and offer information, making it difficult for prospective users to form a view on the reasonableness or otherwise of offers put before them. To address this issue, the AEMC recommended the introduction of a financial and offer information disclosure regime for light regulation pipelines.

In order to improve information and negotiation outcomes, the AEMC also recommended:

- renaming the Scheme Register and update its required contents to include additional non-scheme pipeline information
- clarifying the role of the regulator in passing on information requests to service providers
- removing the requirement to provide KPIs as part of the access arrangement information

The AEMC's recommendations and proposed rules are outlined below.

Negotiation and information: AEMC recommendation and COAG Energy Council rule change request

Recommendation 21: Require transmission pipeline service providers to disclose augmented Bulletin Board information

Amend the NGR in order to:

- require all full and light regulation transmission pipelines to become Bulletin Board pipelines
- augment Bulletin Board reporting for transmission pipelines so that the outlook of uncontracted primary pipeline capacity for Bulletin Board pipelines is extended from 12 months to 36 months
- remove the requirement for scheme pipeline service providers to establish and maintain a public register of spare capacity.

This recommendation is reflected in the proposed amendments to rules 141, 145 and 177, and the proposed omission of rule 111 of the NGR.

Recommendation 22: Require distribution pipeline service providers to disclose capacity and usage information

Require all full and light regulation distribution pipelines to publish capacity and usage information that is based on the information requirements applying to non-scheme pipelines, modified to be more suitable for distribution pipelines.

This recommendation is reflected in the proposed new rules 35B, 36A to 36C in Part 7, and 112A to 112D in Part 11 of the NGR.

Recommendation 23: Clarify the role of the regulator in passing on information requests to service providers

Provide the regulator with the ability to decide whether or not to pass on all or part of an information request, subject to guidance.

This recommendation is reflected in the proposed amendments to rule 107 of the NGR.

Recommendation 24: Introduce a financial and offer information disclosure regime for light regulation pipelines

Require that light regulation pipeline service providers publish a financial and offer information set out in the NGR, based on the requirements that apply to non-scheme pipeline service providers but adjusted so that the reported capital base is calculated in a manner consistent with the method applying to full regulation pipelines.

This recommendation is reflected in the proposed amendments to rule 36 and proposed

rules 35B, 36A, 36D, 36E and 36F in Part 7 of the NGR.

Recommendation 25: Remove the requirement to provide KPIs as part of the access arrangement information

Remove the requirements on service providers to include KPIs in the access arrangement information.

This recommendation is reflected in the proposed amendments to rules 45 and 72 of the NGR.

Recommendation 26: Improve the Scheme Register

Amend the NGR such that:

- service providers for non-scheme pipelines be required to provide the AEMC with a description of the pipeline upon commencement of the relevant rule. Subsequently, both scheme and non-scheme pipeline service providers should be required to provide a description of the pipeline for inclusion in the register whenever a new pipeline is built or when it is affected by an extension or expansion
- the Scheme Register's contents be expanded to include published information about:
 - access determinations made under Division 4 of Part 23 of the NGR
 - exemption decisions made under Division 6 of Part 23 of the NGR
 - initial opening capital base determinations for light regulation pipelines
- the name Scheme Register be changed to Pipeline Register
- the current requirement for the Scheme Register to be made available for inspection at the AEMC's public offices during business hours be removed from the NGR.⁵

This recommendation is reflected in the proposed amendments to rules 133 to 135, and proposed new rule 135A in Part 14 of the NGR.

HOW DOES THE PROPOSED RULE CHANGE REQUEST CONTRIBUTE TO THE ACHIEVEMENT OF THE NATIONAL GAS OBJECTIVE?

The National Gas Objective is to:

“... promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas”

As set out in the AEMC's final report, the Energy Council's proposed rule changes are expected to contribute to the achievement of the NGO in the following respects.⁶

Expansions and extensions

The proposed changes to rule 104 will include all future pipeline expansions as part of the relevant covered pipeline. The proposed amendment also allows service providers to include existing pipeline extensions as part of the relevant covered pipeline.

⁵ The register will continue to be available on the AEMC website

⁶ AEMC, *Review into the scope of economic regulation applied to covered pipelines*, Final report, 3 July 2018 pp. 9 – 12.

These amendments are expected to support effective negotiations between service providers and users as well as bringing related pipeline assets under one regulatory framework, reducing the regulatory burden for some service providers. The changes will also enable regulators to make better informed decisions on allocation of costs and consequently, establish reference tariffs that reflect the cost of providing those reference services.

Reference services

The Energy Council's proposed rule changes to include a new rule 47A, the proposed amendment of rule 48 and omission of rule 101 will result in a new approach to determining which pipeline services should be specified as reference services in a full access arrangement. The amendments to rule 45 deal with light regulation pipeline access arrangements. The NGR will now include new criteria for reference services which enable the reference services specified in a full access arrangement to better reflect the variety of different services that have become more common of late due to recent changes in the dynamics of the east coast gas market (such as bi-directional services and park and loan services).

The Energy Council's rule change proposal also includes the introduction of a new reference service process. The new process will provide users with greater opportunity for engagement regarding the decision about which services are specified as reference services, as well as providing regulators with a specific framework to focus on this important question at an early stage of the access arrangement assessment process.

The new process is set out in the proposed new rule 47A, the omission of rules 13 and 57 and the amendments to rules 45, 50, 59 and 62.

The proposed changes to the NGR are expected to support effective and informed decision making on pipeline and reference services without the creation of a significant additional regulatory burden. The expected identification of more reference services for pipelines will enable users and prospective users to be more informed in negotiating their use of pipeline services.

Access arrangements

The Energy Council's proposed rule seeks to improve the access arrangement process by making changes to:

- timeframes specified for the access arrangement assessment process (proposed amendment to rule 59 of the NGR).
- the limited and no regulatory discretion framework (proposed omission of rule 40 of the NGR (as well as amendments to rules 41, 50, 79, 89, 91, 94 and 95 of the NGR).
- use of regulator developed financial models (proposed new rules 75A and 75B of the NGR).

The adjustments to timeframes will provide more time for stakeholder engagement. Decision making will also be improved by the removal of the current limitations on regulatory discretion that apply to certain elements of an access arrangement, clarifying that the regulator has the power to make decisions that best contribute to the NGO. In addition, the recommendation for service providers to use regulator developed financial models will enable stakeholders to more easily participate in this aspect of assessing an access arrangement proposal as well as supporting quicker and lower cost decision making by the regulator.

The Energy Council has proposed amendments to rules 97 and 100 of the NGR to clarify that the regulator is to consider the allocation of risks when making a decision on an access arrangement proposal, in order to address the concerns that an undue amount of risk may be placed on pipeline users through the non-tariff terms and conditions for reference services. This proposed rule also supports the making of decisions that are consistent with the efficient use of pipeline

services that would be in the long term interests of consumers by assisting in the allocation of risks to the parties that can best manage them.

The Energy Council has proposed amending rule 92 of NGR in relation to the operation of an access arrangement:

- the operation of revenue caps
- the operation of the interval of delay (also includes proposed amendments to rule 3 of the NGR).

These proposed rules will improve stakeholder understanding of the operation of an access arrangement and provide greater clarity to the regulator when making a decision regarding these elements of an access arrangement.

Determining efficient costs

The Energy Council's rule change proposal includes amendments to the NGR regarding:

- new capital expenditure criteria (proposed amendment to rule 79)
- speculative capital expenditure (proposed amendment to rule 84)
- cost allocation (proposed amendments to rules 79 and 91)
- rebateable services (proposed amendments to rules 93 and 97).

These proposed amendments aim to clarify the relevant NGR criteria in order to support the regulator in making decisions that promote the NGR on these elements of an access arrangement proposal. In particular, these decisions will impact on the calculation of reference tariffs which will in turn improve user decisions on their use of, and investment in, gas services.

Negotiation and information

The Energy Council's proposed amendments to the NGR⁷ in relation to information provision will enable users and prospective users to make well informed decisions on the pipeline services that they may wish to use and the terms and conditions associated with those services. This is critical to the ability of users and prospective users to negotiate with service providers. It will in turn enable users and prospective users to make efficient decisions regarding their own business operational and investment requirements, which flow through to consumers of gas. This is consistent with COAG Energy Council's vision for the Australian gas market – that parties are able to access relevant information to participate in the market. In addition, the publication of accurate and relevant information in a timely manner by service providers will enable well-informed regulatory and policy decisions to be made.

This rule change request seeks to assist pipeline users and prospective users to negotiate lower prices and better terms for their gas transportation agreement therefore assisting to meet the National Gas Objective.

EXPECTED POTENTIAL IMPACTS OF THE PROPOSED CHANGE TO THE RULES ON THOSE LIKELY TO BE AFFECTED

The rule changes clarify obligations in relation to the treatment of extensions and expansions, information and disclosure, and access arrangements and will impact operating procedures for pipeline operators and pipeline services providers, regulators and AEMO.

There may be some costs associated with the implementation of the improved regulatory arrangements that are designed to make it cheaper and easier to move gas around the market. On balance, the Energy Council considers these costs are outweighed by the benefit.

⁷ Proposed amendments to rules 36, 45, 72, 107, 133-135, 141, 145, 177; the proposed omission of rule 111 and insertion of 35B, 36A, 36D to 36F and 135A.

The package of rule changes in this proposal will assist pipeline users and prospective users to negotiate lower prices and better terms for their gas transportation agreements. A broader range of pipeline services will be subject to access arrangements, prices for services will be set at more efficient and cost reflective levels, contract terms will be more balanced, greater information will be provided to pipeline users to aid their negotiations, and arbitration will act as a more credible back-stop if negotiations fail. The changes will also address information asymmetry issues identified by the AEMC. This will be through more relevant, timely and accessible information for users and prospective users to inform their negotiations with service providers. The five areas reflected in the package are briefly summarised and articulate what impact the recommendations will likely have on covered pipeline stakeholders and the economic regulatory environment.

Expansions and Extensions

The proposed recommendations to changes in the NGR will reduce the prospect of service providers exercising monopolistic pricing over the expansions and extensions, which is in the long term interest of consumers. The implementation of the rule change should see the erosion of monopoly profits, to the extent that they are being realised by service providers, as well as improvements to the efficiency of the market. However, there may be additional administrative and regulatory costs associated with providing (service provider) and assessing (regulator) information on expansions and extension in the access arrangement.

Reference Services

Amendments to the NGR relating reference services will aim to reduce ambiguity in the definitions which will reduce regulatory complexity for all stakeholders. This will improve the prospect of the regulator determining the appropriate number and type of reference services in response to a service provider's proposal. It will also better enable pipeline users (who are the users of reference services) and other stakeholders to engage with and inform the reference service setting process. The introduction of the reference service proposal process may result in cost and regulatory burden associated with an ex ante determination of reference services for an access arrangement. This includes the cost and regulatory burden for service providers, the regulator and other stakeholders of determining reference services and corresponding reference tariff and non-tariff terms and conditions.

Access Arrangements

The recommendations aim to provide clarity and certainty around full access arrangement processes in order to reduce regulatory and administrative burden and better facilitate outcomes for pipeline users, and ultimately gas consumers. There may be some transitory impost linked with the changes to the full access arrangement process for regulators and service providers. In particular, there will be costs involved in the development of the regulator's financial models, as associated stakeholder consultation, engagement and training.

Determining Efficient Costs

Determining and reconfiguring the accurate determination of efficient costs will create more efficient investment in the pipelines. This section, as articulated through the final report highlighted a range of differing impacts dependant on the stakeholder. The issues relate to the assessment of capital and operating expenditure, the determination of the capital base, including the application and meaning of depreciation in this context. As a result of these changes to the NGR there may be some redistribution of costs as users pay for the services they use rather than other services they do not. This supports the efficient use of pipeline services.

Negotiation and Information

The recommendations in this section will improve up-to-date disclosure obligations on other full and light regulation pipeline service providers that are limited, meaning that prospective users will have more information in their access negotiations. Requiring service providers to publish

more information will make it easier for prospective users to form a view on the reasonableness or otherwise of offers put before them. The implementation of these changes may create some compliance costs for service providers.

SUMMARY OF THE CONSULTATION CONDUCTED BY THE AEMC

Over the course of the 12 month review, the AEMC released four papers⁸ and received 38 submissions. In addition, the AEMC met more than 25 stakeholders including gas pipeline service providers, users and relevant jurisdictional policy bodies (summarised below). The AEMC also held regular meetings with the ACCC, AER, ERA and Gas Market Reform Group (GMRG).

| Review stage | Date | No. submissions received |
|-----------------------|------------------|--------------------------|
| Issues paper | 27 June 2017 | 20 |
| Interim report | 31 October 2017 | No submissions invited |
| Draft report | 27 February 2018 | 18 |
| Final report | 3 July 2018 | No submissions invited |

Note: the AEMC also held a workshop to discuss the issues raised in the Interim report (14 December 2017).

⁸ AEMC, Review into the scope of economic regulation applied to covered pipelines: Issues paper (27 June 2017); Interim report (31 October 2017); Draft report (27 February 2018); Final report (3 July 2018).

In response to the draft report, in which the Commission’s draft recommendations were articulated, 18 submissions were received from the following organisations:

| Service providers | Users (producers/retailers) | Users (industrials/GPG) | Government/advocacy |
|---|--------------------------------|--|---|
| APA Group | EnergyAustralia | Major Energy Users (MEU) | Australian Competition & Consumer Commission (ACCC) |
| Jemena Gas Network | Origin Energy | Energy Users Association of Australia (EUAA) | Australian Energy Regulator (AER) |
| Australian Pipelines and Gas Association (APGA) | AGL | | Economic Regulation Authority WA (ERA) |
| Australian Gas Infrastructure Group (AGIG) | Central Petroleum | | National Competition Council (NCC) |
| | AusNet | | Public Interest Advocacy Centre (PIAC) |
| | | | WA Energy Disputes Arbitrator |