



public interest
ADVOCACY CENTRE

**PIAC submission to the AEMC Review into the
scope of economic regulation applied to
covered pipelines Issues Paper**

23 August 2017

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Summary of Recommendations

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PIAC recommends that the AEMC, in investigating whether the current regulatory framework achieves the objective of supporting long-term consumer interests, considers any limitations brought about by the absence of a single national energy objective for gas regulation as well as other energy frameworks.

Recommendation 2

PIAC recommends that the AEMC considers the merits of the coverage test reforms proposed by the ACCC.

Recommendation 3

PIAC asks that the AEMC consider where benefits delivered by an access arrangement process can outweigh the costs, and how the developments noted may contribute to limit those costs.

Recommendation 4

PIAC recommends that the AEMC explores if the negotiate-arbitrate regulatory framework would suffice to promote the long-term interests of consumers at the distribution pipeline level, particularly considering the outcomes under light regulation discussed herein.

Recommendation 5

PIAC recommends that the AEMC improves recognition of consumer consultation in the access arrangement process for covered pipelines.

Recommendation 6

PIAC recommends that the AEMC examines the asymmetry between service providers and customers seeking to change the level of regulation applied to pipelines.

Recommendation 7

PIAC recommends that the AEMC examine how light regulation is applied to distribution pipelines, with particular regard to the consumer impacts of this practice.

Recommendation 8

PIAC recommends that the new information provision and arbitration framework be monitored to ensure that it is working as envisaged before any decision on the removal or amendment of the light regulation regime be made.

Recommendation 9

PIAC recommends that AEMC considers how pipelines currently subject to light regulation would transition to the new regime if light regulation is removed.

Recommendation 10

PIAC recommends that the AEMC remove the scope for limited regulatory discretion in access arrangement decisions. The AER should have no discretion over the access arrangement

elements where that level of discretion currently applies, and full discretion over all other elements.

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PIAC recommends that the AER continue to assess both forecast and actual capital expenditure as part of the regulatory process for covered pipelines.

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PIAC recommends that the AEMC consider adopting a regulatory investment test, or similar, for gas pipelines.

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PIAC recommends that the extensions and expansion discretion be exercised by the AER on a risk basis.

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PIAC recommends that the AEMC considers how to incentivise service providers to use the speculative capital expenditure account for capital expenditure that is of a speculative nature.

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PIAC recommends that the AEMC consider removing KPI reporting as part of access arrangements given that it does not result in useful additional information being provided.

Recommendation 19

PIAC recommends that the AEMC examine how to increase consistency in reference service definitions across different pipelines.

Recommendation 20

PIAC recommends that the AEMC consider the implementation of a market power reference service definition in order to prevent monopoly pricing of pipeline services that do not meet the current market demand definition.

Recommendation 21

PIAC recommends that the AEMC implement a framework and approach process for access arrangements.

Recommendation 22

PIAC recommends that the AEMC use this review to investigate how a broader range of pipeline services could be captured under the light regulation regime.

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PIAC recommends that the AEMC investigate how a broader range of pipeline services could be captured under the light regulation regime.

Recommendation 24

PIAC recommends that the AEMC identify how the Bulletin Board could be used to support access arrangement information provision.

Recommendation 25

PIAC recommends that all services provided through covered pipelines should be subject to arbitration as far as practicable.

Recommendation 26

PIAC recommends that the AEMC use this review to consider if, and why, the AER, and/or ACT tends to approve higher-than-efficient cost recovery through reference tariffs.

Recommendation 27

PIAC recommends that the AEMC consider tariff issues in the context of AER inflation and rate of return review processes.

Recommendation 28

PIAC recommends that the AEMC consider how the NGR could recognise partially covered pipelines and provide specific guidance on consistent cost allocation methodologies across covered and non-covered sections of such pipelines.

Recommendation 29

PIAC recommends that the AER continue to have full discretion over tariff variation.

Recommendation 30

PIAC recommends that the AEMC consider the introduction of a framework and approach process for access arrangements to support consistent tariff variation decision-making across all pipelines.

Introduction

The Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit legal centre based in New South Wales. Established in 1982, PIAC tackles systemic issues that have a significant impact upon disadvantaged and marginalised people. We ensure basic rights are enjoyed across the community through litigation, public policy development, communication and training.

Our work addresses issues such as:

- homelessness;
- access for people with disability to basic services like public transport, education and online services;
- Indigenous disadvantage;
- discrimination against people with mental health conditions;
- access to energy and water for low-income and vulnerable consumers;
- the exercise of police power;
- the rights of people in detention, including the right to proper medical care; and
- government accountability, including freedom of information.

PIAC is funded from a variety of sources. Core funding is provided by the NSW Public Purpose Fund and the Commonwealth and State Community Legal Services Program. PIAC also receives funding from the NSW Government for its Energy and Water Consumers Advocacy Program and from private law firm Allens for its Indigenous Justice Program. PIAC also generates income from project and case grants, seminars, donations and recovery of costs in legal actions.

Energy and Water Consumers' Advocacy Program

The Energy + Water Consumers' Advocacy Program (EWCAP) represents the interests of low-income and other residential consumers of electricity, gas and water in New South Wales. The program develops policy and advocates in the interests of low-income and other residential consumers in the NSW energy and water markets. PIAC receives policy input to the program from a community-based reference group whose members include:

- Council of Social Service of NSW (NCOSS);
- Combined Pensioners and Superannuants Association of NSW;
- Ethnic Communities Council NSW;
- Salvation Army;
- Physical Disability Council NSW;
- Anglicare;
- Good Shepherd Microfinance;
- Financial Rights Legal Centre;
- Affiliated Residential Park Residents Association; and
- Tenants Union.

Review into the scope of economic regulation applied to covered pipelines

PIAC welcomes the opportunity to respond to the Issues Paper for the AEMC's Review of the scope of economic regulation applied to covered pipelines. At a general level, PIAC recommends that the AEMC approach this review with a view not only to the interests of direct pipeline users but also to the end consumers of gas.

As a number of recent reviews have noted, the operation of the east coast gas market is notoriously opaque.¹ This opacity means it is often very difficult for users to negotiate fair access to pipelines, often resulting in inefficient investment in and operation of the gas system. This inefficiency has the potential to increase prices for the final consumers that PIAC represents. For this reason, it is vital that a fair and comprehensive regulatory framework is applied to pipelines. PIAC considers this review to be a timely means of ensuring the current regulatory framework is both comprehensive and fair.

Question 1: Purpose of the regulatory framework

1A) What do you think are the objectives of the current regulatory framework? Are the objectives of the framework clear? Has the framework achieved them?

As with any energy regulation, the aim of the current regulatory framework is to support the long-term interest of consumers. This is articulated through the National Gas Objective (NGO), which explicitly links the efficient investment in, and operation of, natural gas services to long-term interests of consumers.² While it has a much wider scope than just pipelines, the AEMC has correctly noted that this review must be conducted with a view to its impact on the NGO.³

While PIAC supports the link between current pipeline regulation and consumer interests as expressed in the NGO, in the absence of a single overarching energy objective the separation of fuel sources between the NGO and National Electricity Objective (NEO) can lead to less than optimal outcomes for consumers.

In 2014, the Alternative Technology Association (ATA) found that due to improvements in common household electrical appliances, connecting new gas supplies was no longer an economic option for residential consumers when efficient electric options are available⁴. ATA's findings, which have since been supported by analysis by Grattan Institute, Melbourne Energy Institute, AEMO and other independent researchers, are evidenced by a trend away from connecting new homes to gas and many existing gas homes moving appliances to electricity.

¹ See: ACCC, Inquiry into the east coast gas market, Final Report, April 2016, Melbourne; AEMC, East Coast Wholesale Gas Markets and Pipeline Frameworks Review, Stage 2 Final Report, May 2016, Sydney; COAG Energy Council, Examination of the current test for regulation of gas pipelines, Report, December 2016, Canberra.

² National Gas Law s23.

³ AEMC, Review into the scope of economic regulation applied to covered pipelines, Issues Paper, 27 June 2017, Sydney, 13.

⁴ ATA, *Are we still cooking with gas?*, November 2014, 5, <http://www.ata.org.au/wp-content/projects/CAP_Gas_Research_Final_Report_251114_v2.0.pdf>.

Given this, PIAC contends that significant investment in new gas pipelines to connect households to the gas system is likely to be inherently inefficient and, arguably, not in consumers' long-term interests. Understanding the merits of such investment may be harder under the NGO, and therefore the current pipeline regulatory framework, because that objective only has regard to consumers interests in the efficiency of gas system investment and operation, not *energy* system investment and operation. Without an overarching national *energy* objective, there is a false distinction between the NGO and NEO that limits the current framework's ability to achieve its objective of supporting long-term consumer interests.

Nonetheless, PIAC does consider the current regulatory framework's broad purpose is to promote long-term consumer interests. The Issues Paper notes that the underlying purpose of the current framework is to enable pipeline users "access to essential facilities at fair and reasonable terms".⁵ While this does not specifically address consumers, it is directly related to the efficient operation and use of natural gas services that the NGO states should help promote the consumer interests. Given their centrality to gas supply, efficiently operated pipeline services should play a significant role in servicing the long-term interests of consumers. Inefficiently high pipeline charges inherently contribute to poor consumer outcomes through higher energy costs. That the current framework promotes fair and reasonable access suggests that it intends to promote long-term consumer interests.

Despite this, the current framework has is not always successful in supporting the long-term interests of consumers. As the Issues Paper notes, there have been a number of reviews conducted by the AEMC, the ACCC, Dr Michael Vertigan and others that touch on issues relevant to this AEMC review.⁶ Through these reviews, there has been an acknowledgement that the current regulatory framework has allowed pipeline service providers to gain significant market power. For example, the ACCC found "evidence that a large number of the major arterial pipelines on the east coast and pipelines servicing regional areas are using their market power to engage in monopoly pricing".⁷

Clearly, the use of market power to charge inefficiently high prices to pipeline users does not constitute the access at fair and reasonable terms noted in the Issues Paper, so it is contrary the long-term consumer interests that are central to the NGO. As noted in PIAC's submission to the Vertigan coverage test review (attached as Appendix A), the centrality of gas pipelines to the gas supply chain means that the failure of pipeline service providers to provide fair and reasonable access pricing inefficiently inflates the energy prices paid by consumers, both for gas itself and for gas-generated electricity.⁸

Given its failure to support both fair access and long-term consumer interests, the current regulatory framework cannot be considered to have achieved its objective.

⁵ AEMC, Review into the scope of economic regulation applied to covered pipelines, 41.

⁶ *Ibid*, 3.

⁷ ACCC, Inquiry into the east coast gas market, 92.

⁸ PIAC, *Testing the bounds of regulation: Submission in response to the Examination of the current test of regulation of gas pipelines*, October 2016, 6, <<http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/Public%20Interest%20Advocacy%20Centre%20response%20to%20gas%20pipeline%20coverage%20test%20consultation.pdf>>.

Recommendation 1

PIAC recommends that the AEMC, in investigating whether the current regulatory framework achieves the objective of supporting long-term consumer interests, considers any limitations brought about by the absence of a single national energy objective for gas regulation as well as other energy frameworks.

1B) Are the objectives of the current regulatory framework still relevant, or should they focus on different issues such as monopoly pricing?

As noted in response to Question 1A, the current framework has failed to prevent pipeline service providers from engaging in monopoly pricing.⁹ The high prices associated with this behaviour by service providers have a material impact on energy bills. To protect consumers, the regulatory framework should consider the impacts of market power and monopoly pricing.

In particular, the coverage test should be changed.¹⁰ Regulatory coverage of gas pipelines is currently determined in accordance with section 15 of the National Gas Law (NGL). The current criteria for coverage is:

- a. that access (or increased access) to pipeline services provided by means of the pipeline would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the pipeline services provided by means of the pipeline;
- b. that it would be uneconomic for anyone to develop another pipeline to provide the pipeline services provided by means of the pipeline;
- c. that access (or increased access) to the pipeline services provided by means of the pipeline can be provided without undue risk to human health or safety; and
- d. that access (or increased access) to the pipeline services provided by means of the pipeline would not be contrary to the public interest.¹¹

This framework, particularly subsection (a), is insufficient, as it is only used to determine if access will produce an increase in competition in a market downstream of the pipeline. In practice, this requirement has proved very difficult to fulfil and many pipelines with market power are left without regulatory cover. As noted by the ACCC, this lack of cover has contributed to the monopoly pricing market failure identified above.¹²

To rectify this regulatory failure, PIAC supports the ACCC's proposed amendments to the coverage test. In its inquiry report, the ACCC suggested that coverage criteria for regulation of pipelines should be changed to

... focus on whether:

- a. the pipeline in question has substantial market power
- b. it is likely that the pipeline will continue to have market power in the medium term

⁹ ACCC, Inquiry into the east coast gas market, 8.

¹⁰ For further detail, see PIAC's submission to the 'Examination of the current test for the regulation of gas pipelines' attached as Appendix A.

¹¹ NGL, s15.

¹² ACCC, Inquiry into the east coast gas market, 10-11.

- c. coverage of the pipeline will or is likely to contribute to the achievement of the National Gas Objective (NGO)...”¹³

Such an amendment would prevent pipelines from remaining uncovered when there is a risk of them engaging in monopoly pricing. Dr Vertigan did not adopt this recommendation in the recent COAG Energy Council review of the coverage test.¹⁴ While PIAC supports the recommendations in that report that seek to strengthen information provision and arbitration requirements for non-scheme pipelines, we are of the view that that those reforms should not preclude amendment of the coverage test as per the ACCC’s recommendations. If anything, these reforms should work in concert to improve coverage of pipelines and strengthen the position of those for whom pipeline access remains uncovered.

Recommendation 2

PIAC recommends that the AEMC considers the merits of the coverage test reforms proposed by the ACCC.

1C) Has the current incentive-based framework appropriately incentivised the efficient operation, use and investment in pipelines? Should a different approach to incentives be considered?

PIAC has not formed a view on this issue.

1D) Are there other third-party access regimes (for example, for rail, ports or telecommunications) that would better achieve the purpose of the gas regulatory framework?

PIAC does not have suggestions about alternative third-party access regimes. However, PIAC urges caution in looking to import a regime wholesale from another sector. While it is appropriate to consider the merits of other schemes, gas pipelines have particular requirements and that should be considered in this context.

Question 2: Efficiency of full regulation

2A) Do you consider that the benefits delivered by the access arrangement review process for a full regulation pipeline outweigh the costs?

In most cases, yes.

The access arrangement review process is a key element in protecting consumers from the potential abuse of market power. By providing a benchmark agreement, access arrangements allow users and prospective users to more effectively negotiate with pipeline service providers.

Furthermore, the ‘efficient’ costs associated with this process may be overstated by service providers. While PIAC acknowledges that service providers need to invest some time and effort in the process, they also choose to commission a large volume of consultancy work, and engage in protracted appeals processes, in seeking to maximise their revenue; all of which that adds little or no value with respect to the long-term interests of consumers. If service providers were willing to

¹³ Ibid.

¹⁴ COAG Energy Council, Examination of the current test for regulation of gas pipelines, 16.

engage in a less combative, more cooperative regulatory process, these costs may be reduced significantly.

Finally, the AER has recently begun to implement various reforms that will help reduce the costs of the access arrangement process. In particular, PIAC expects moves by the AER towards a more cooperative regulatory process, the removal of Limited Merits Review and a binding rate of return guideline will all reduce costs associated with access arrangements.

Recommendation 3

PIAC asks that the AEMC consider where benefits delivered by an access arrangement process can outweigh the costs, and how the developments noted may contribute to limit those costs.

2B) Is there a regulatory framework that may better achieve the desired objectives compared to the current negotiate-arbitrate framework supported by access arrangements developed under incentive-based economic regulation?

PIAC considers the negotiate-arbitrate framework to be appropriate for transmission pipelines. Customers negotiating with these pipelines are businesses that are relatively able to negotiate access with service providers. While there are clearly asymmetries in these relationships, PIAC contends that the system could work well when combined with a stronger coverage test and a market power-based reference service definition.¹⁵

However, PIAC is concerned about the application of negotiate-arbitrate model in distribution systems, such as those in Queensland where light regulation is currently applied. Unlike in transmission, gas consumers such as households and small businesses are directly connected to the distribution system. Essentially, these consumers rely on gas retail businesses to act as advocates for them by negotiating the best pipeline charge and passing on any saving to consumers.

PIAC understands that this advocacy does not occur in practice. In the limited cases where retailers may be negotiating low pipeline charges for households in gas distribution networks, they are not passing these savings through to consumers. In any case, the process and outcomes are not transparent, and consumers are unable to access the expensive and complicated arbitration processes.

Given this, PIAC is particularly concerned that the negotiate-arbitrate framework will not work to promote the long-term interests of consumers connected to light-regulated gas distribution networks.

Recommendation 4

PIAC recommends that the AEMC explores if the negotiate-arbitrate regulatory framework would suffice to promote the long-term interests of consumers at the distribution pipeline level, particularly considering the outcomes under light regulation discussed herein.

¹⁵ See responses to Q1 and Q11 for more detail.

2C) Do you think that the access arrangement process should be amended to be similar to the revenue determination process for electricity service providers? Should there be greater recognition of consumer consultation?

PIAC supports reforms designed to achieve greater recognition of, and give more weight to, effective and genuine consumer consultation. Currently, the east coast gas market is so opaque that it is very difficult for prospective pipeline users to engage in it, let alone end consumers. As such, it is vital that pipeline service providers and energy market institutions proactively seek to engage with consumers and consumer advocates during gas regulatory processes. This approach is also consistent with the principles outlined by both the AEMC and AER in their respective stakeholder engagement documents.¹⁶ PIAC supports any move to apply these principles more broadly in the access arrangement process.

Recommendation 5

PIAC recommends that the AEMC improves recognition of consumer consultation in the access arrangement process for covered pipelines.

2D) Have the NGR been effective and adaptable to the evolution of the gas industry?

No. As noted in response to Question 1A, with improvements in electrical technology, connecting new gas supplies is no longer an economic option for residential consumers when efficient electric options are available. PIAC is concerned that the NGR are not keeping up with changes in the energy market.

Given this, PIAC contends that significant investment in new gas pipelines to connect households to the gas system is likely to be inherently inefficient and, arguably, not in consumers' long-term interests. Understanding the merits of such investment may be harder under the NGR, and therefore the current pipeline regulatory framework, because that objective only has regard consumers interests in the efficiency of gas system investment and operation, not *energy* system investment and operation. Without an overarching national *energy* objective, there is a false distinction between the NGR and NEO that limits the current framework's ability to achieve its objective of supporting long-term consumer interests.

Question 3: Efficiency of light regulation

3A) Do the form of regulation factors consider relevant structure, conduct and performance issues to enable the NCC to make informed decisions on the application of full or light regulation?

PIAC is concerned about the ease with which service providers are able to change the status of fully covered pipelines to light regulation pipelines. Under Rule 34 of the NGR, an application to the National Competition Council (NCC) can be made to effect this change. While PIAC acknowledges that such a process must exist, it appears that it is much easier for a service provider to complete this change than for pipeline users to do the opposite.

¹⁶ AEMC, *Empowering Consumers: A blueprint for informing and empowering small consumers in NSW energy markets*, October 2013, <<http://www.aemc.gov.au/getattachment/7356b545-1216-412b-ae96-6cf17776a518/Brochure.aspx>>; AER, *AER Stakeholder Engagement Framework 2013*, July 2013,

This problem relates to the power asymmetry between pipeline service operators and the customers for whom regulation of a pipeline is beneficial. While transmission customers are often large users who are able to negotiate on relatively equal terms with service operators, many customers who are directly connected to distribution pipelines are small consumers.

While service providers are large businesses that are financially able to engage with the process, end consumers are unable to do so. Instead, they rely on the direct pipeline customers, gas retailers, to act as advocates on their behalf. PIAC understands, however, that this does not occur. In fact, it can be in a retailer's interest for there to be a lower level of regulation with less transparency; a retailer can negotiate a lower pipeline charge and choose to not pass this through to the end consumer. In this situation, retailers are advocating only for their own margins, not for the consumer.

Given that it is not in retailers' interest to seek to increase coverage, gas consumers are often left with no ability to request a return to full regulation. This is reflected in the fact that it is much more common for pipelines to reduce their coverage than have it increased.

Recommendation 6

PIAC recommends that the AEMC examines the asymmetry between service providers and customers seeking to change the level of regulation applied to pipelines.

3B) Do you consider that the light regulation regime has been fully utilised and appropriately enforced to produce benefits to pipeline users and achieve its objectives? If not, why not?

PIAC is also concerned about the impact of applying the light regulation regime to distribution networks. Recent experience of Queensland gas consumers indicates that the light regulation regime has not been effective in protecting them from detrimental outcomes. PIAC is concerned that this will set a precedent for other gas networks.

In 2014 and 2015, Envestra and Allgas' gas distribution pipelines serving Brisbane have had their coverage changed from full to light regulation by the NCC.¹⁷ There were a number of reasons given for this change.

Firstly, the businesses claimed that the decline in Brisbane's residential gas customer base meant the costs of the access arrangement process associated with full regulation would be too onerous for both the business and the consumers for whom they were passed on to.¹⁸

Secondly, it was claimed that the decline in demand was such a strong incentive to reduce prices that full regulation was not needed to ensure good consumer outcomes.¹⁹

¹⁷ NCC, *Light Regulation of Envestra's Queensland Gas Distribution Network*, November 2014, <<http://www.aemc.gov.au/getattachment/c9fbd4d2-fe4b-41d2-9f73-33635129bb0a/Light-regulation-final-decision-and-statement-of-r.aspx>>; NCC, *Application by Allgas Energy Pty Ltd for Light Regulation of the Allgas Gas Distribution Network – Final Decision*, April 2015, <<http://www.aemc.gov.au/getattachment/e9e7a55c-425b-4f11-8177-b4731ef5ea81/Light-regulation-final-decision-and-statement-of-r.aspx>>.

¹⁸ NCC, *Application by Allgas Energy Pty Ltd for Light Regulation of the Allgas Gas Distribution Network – Final Decision*, 7.

¹⁹ *Ibid*, 5.

Finally, both networks made the case that distribution pipelines would have been unable to exercise market power even if demand had remained high. This was based on the assertion that natural gas is a fuel of choice, meaning that the potential for consumers to switch to electric appliances puts competitive pressure on gas networks to reduce costs.

Later, in response to concerns from retailers, both service providers committed to not raise prices at a rate above the Consumer Price Index (CPI) from the initial price on changing to light regulation.²⁰

The decision to lightly regulate the Brisbane pipelines raises four concerns for PIAC.

Firstly, there was a lack of transparency in the decisions. In both cases, the NCC only received submissions from very small numbers of retailers and, in the Envestra case, the retailers peak body, then known as the Energy Retailers Association of Australia.²¹ While retailers are the most directly affected users of distribution pipelines, PIAC would expect, given the clear consumer impact of distribution network regulatory decisions, that Queensland consumer advocates would also be interested in submitting to this process. However, anecdotal evidence from the consumer advocate community in Queensland suggests that they were unaware of the changes until well after the decisions were made. This suggests that the service providers and the NCC did not actively seek consumer input into the decision despite its importance to consumers. PIAC considers this to be poor stakeholder engagement practice that goes against the engagement principles promoted by other energy decision-making institutions such as the AER and AEMC.²²

Secondly, the argument that consumers will benefit from the reduction in regulatory costs for service providers requires retailers to act as advocates for their customers. When pipelines no longer have fully regulated access arrangements, it is incumbent upon retailers to negotiate low pipeline charges on behalf of consumers and then actually pass them on. PIAC contends, however, that this does not occur. While retailers have been able to negotiate lower prices with the pipeline service providers,²³ PIAC is aware of anecdotal reports that any reductions negotiated have not been passed on to consumers. In this situation, consumers are not seeing any benefit from the change to light regulation. Instead, they are receiving the same prices while the pipeline service providers benefit from a lower regulatory burden and retailers increase their margins.

Thirdly, PIAC does not accept that distribution networks are not in a position to exercise market power. As stated above, this claim largely rests on the assertion that gas is a fuel of choice. For many consumers, however, this is simply not the case. For some consumers, the cost of changing household appliances from gas to electricity may be too high, while for renters it not a decision they can make for themselves. In such situations, electricity is unable to provide any competitive pressure and consumers are forced to remain gas users no matter what price

²⁰ NCC, *Light Regulation of Envestra's Queensland Gas Distribution Network*, 10; NCC, *Application by Allgas Energy Pty Ltd for Light Regulation of the Allgas Gas Distribution Network – Final Decision*, 8.

²¹ NCC, *Application by Allgas Energy Pty Ltd for Light Regulation of the Allgas Gas Distribution Network – Final Decision*, 7;

²² AEMC, *Empowering Consumers: A blueprint for informing and empowering small consumers in NSW energy markets*, October 2013; AER, *AER Stakeholder Engagement Framework 2013*, July 2013.

²³ NCC, *Light Regulation of Envestra's Queensland Gas Distribution Network*, 20; NCC, *Application by Allgas Energy Pty Ltd for Light Regulation of the Allgas Gas Distribution Network – Final Decision*, 8.

pipeline service providers charge. Given that these pipelines are a natural monopoly, this is precisely the situation in which service providers can exercise market power.

PIAC's final concern is that by linking gas distribution charges to CPI, Envestra and Allgas have avoided natural reductions in price. While CPI-linked pricing was sold as a safeguard for consumers, PIAC contends that it has not worked as such. Instead, it has sustained Brisbane pipeline charges at artificially high level, reflecting post-GFC rates of return, during a period of declining charges in covered distribution pipelines. PIAC acknowledges that, in theory, some price certainty is provided by such a 'safeguard', however the CPI link has contributed to potential consumer detriment related to light regulation in distribution pipelines.

Recommendation 7

PIAC recommends that the AEMC examine how light regulation is applied to distribution pipelines, with particular regard to the consumer impacts of this practice.

3D) Having regard to the new proposed non-scheme pipeline regulatory arrangements on information disclosure and arbitration, is the light regulation regime still relevant? Should it be retained, removed or amended?

PIAC supports the recommendations from Dr Vertigan's review of the pipeline coverage test to strengthen information provision and arbitration requirements for non-scheme pipelines. The final design of these mechanisms seeks to create a light negotiate-arbitrate framework for non-scheme pipelines that facilitates access to pipeline services "at prices and on terms and conditions that so far as practical reflect the outcomes of a workably competitive market".²⁴ Essentially, the proposed system seeks to extend something very similar to light regulation to non-covered pipelines.

PIAC agrees with Dr Vertigan's statement that the light regulation option may no longer be necessary if the new framework operates as it has been envisaged.²⁵ However, PIAC considers it prudent that the operation of the new framework be assessed before removing the light regulation regime. If the framework does indeed work to replace the light regulation regime, it could be removed. Until that has been established, the light regulation regime should remain in place.

Furthermore, if a decision is reached to remove the current light regulation regime, there must be consideration of the transition for pipelines currently subject to that form of regulation. For example, would pipelines currently subject to light regulation be held to commitments made under that regime once it is removed? The AEMC should explore potential transition arrangements in this review.

Recommendation 8

PIAC recommends that the new information provision and arbitration framework be monitored to ensure that it is working as envisaged before any decision on the removal or amendment of the light regulation regime be made.

²⁴ GRMG, Gas Pipeline Information Disclosure and Arbitration Framework, Final Design Recommendation, June 2017, 58, <<http://gmrq.coagenergycouncil.gov.au/sites/prod.gmrq/files/publications/documents/gas-pipeline-information-disclosure-and-arbitration-framework-final-design-recommendation-june-2017.pdf>>.

²⁵ COAG Energy Council, Examination of the current test for regulation of gas pipelines, 15-16.

Recommendation 9

PIAC recommends that AEMC considers how pipelines currently subject to light regulation would transition to the new regime if light regulation is removed.

Question 4: Efficiency of regulatory discretion

4) Do you consider that the three levels of regulatory discretion in approving elements within an access arrangement are useful and assigned properly?

PIAC agrees with the AEMC's assertion that the reasons for allocating different levels of discretion to the AER for particular elements of access arrangements are unclear.²⁶ As such, PIAC considers this review an appropriate opportunity for clarifying the purpose and operation of this system. PIAC suggests that the AEMC should consider amending the current discretion levels so that there are only two: 'no discretion' and 'full discretion'.

PIAC does consider it a reasonable safeguard for service providers that the AER is unable to exercise undue discretion over access arrangement periods, submission dates and review dates. PIAC cannot foresee a necessity for the AER to require the discretion to modify such elements of the process. Conversely, it is desirable for service providers to have certainty about timing. Therefore, PIAC supports retaining the current 'no discretion' level.

PIAC does, however, support removing 'limited discretion' and giving the AER full discretion over all access arrangements elements where they are currently limited. Currently, the AER has limited discretion over depreciation schedules and conforming capital expenditure. PIAC does not consider these elements to require less discretion on the part of the AER than anything else in an access agreement. The centrality of these elements to the costs recouped by service providers suggests to PIAC that the AER should be able to exercise more discretion, not less. Allowing the AER to suggest preferable options regarding depreciation schedules and conforming capital expenditure should be a key method of protecting pipeline users and consumers from unreasonable revenue recovery.

PIAC contends that giving the AER full discretion would not prevent the AER from accepting proposals from service providers that reflect individual businesses and their knowledge of their assets. The AER may well continue to accept NGR-conforming proposals straight from service providers. It would, however, allow the AER to assess these proposals within a set of consistent principles and policies. In recent decisions, for instance, the networks have proposed depreciation schedules that greatly increase costs to current consumers, though being NPV-neutral over the life of the assets, and the AER has no discretion to reject these as not in the long-term interests of consumers. PIAC recommends that the AER should be given full discretion in all decisions where they are currently given limited discretion.

Recommendation 10

PIAC recommends that the AEMC remove the scope for limited regulatory discretion in access arrangement decisions. The AER should have no discretion over the access arrangement elements where that level of discretion currently applies, and full discretion over all other elements.

²⁶ AEMC, Review into the scope of economic regulation applied to covered pipelines, 46.

Question 5: Conforming capital expenditure

5A) Do you consider it beneficial that both forecast and actual capital expenditure are assessed by the regulator?

Yes. Given the general opacity of the east coast gas market, it is appropriate for the AER to have access to, and assess as needed, all projected and historical information possible when making their regulatory decisions. It is essential that the regulator and consumers have insight into if and how current capital allowances have been spent. Furthermore, if the introduction of a capital expenditure efficiency scheme for gas proceeds, it would require transparency on actual expenditure in the current regulatory period to determine whether this was efficient expenditure.

Recommendation 11

PIAC recommends that the AER continue to assess both forecast and actual capital expenditure as part of the regulatory process for covered pipelines.

5B) Does an appropriate level of regulatory scrutiny on investment occur if the regulator's discretion is limited?

No. As outlined in response to Question 4, PIAC contends that the AER should have full discretion over conforming capital expenditure.

Further, PIAC notes that there is not an appropriate level of regulatory scrutiny on pipeline investment in general. Unlike in electricity networks, the AER does not have a regulatory investment test (RIT) process for gas. In electricity, RITs are transparent, standardised cost-benefit analyses of proposed network investment. This allows the AER to properly assess proposed capital expenditure by network service providers.

PIAC considers a RIT to be the appropriate mechanism for regulatory scrutiny of investment proposals by network service providers and is of the view a similar test model should be applied to gas pipelines. This would increase transparency in a market that is generally regarded as opaque and provide a proven framework through which the AER could effectively assess capital expenditure by covered pipeline service providers. The implementation of a RIT for gas pipelines would have the benefit of providing an opportunity for proper investigation of alternative supply options, something possibly lacking from the pipeline regulatory framework.

Recommendation 12

PIAC recommends that the AEMC consider adopting a regulatory investment test, or similar, for gas pipelines.

5C) Can the same capital expenditure criteria apply to both market carriage and contract carriage pipelines? And to both transmission and distribution pipelines?

PIAC has not formed a view on this issue.

Question 6: Extension and expansion requirements

6A) Should there be discretion regarding which extensions and expansions are to be included as part of a covered pipeline? On which basis do you think that such discretion should be exercised?

PIAC considers AER discretion over gas regulatory decisions to be desirable. This discretion should be exercised on a risk basis. PIAC considers it appropriate for speculative expansions and extensions of pipelines to be uncovered so the risk is not transferred on to existing pipeline users and gas consumers. However, it is appropriate for non-speculative extensions and expansions to be covered.

Recommendation 13

PIAC recommends that the extensions and expansion discretion be exercised by the AER on a risk basis.

6B) If a pipeline is partially covered, does the impact on the application of the cost allocation and tariff setting rules? Does it impact on the other aspects of an access arrangements?

6C) Should the same extension and expansion requirements apply to both market carriage and contract carriage pipelines? And to transmission and distribution pipelines?

PIAC has not formed views on these issues.

Question 7: Investment in excess capacity

7A) In your opinion, why has the speculative capital expenditure account rarely been used?

PIAC contends that the speculative capital expenditure account is rarely used because there is limited incentive for service providers to use it. Instead, it is in service providers' interests to include speculative investment in as conforming capital expenditure which can be recovered from pipeline users. This represents an unacceptable transfer of risk from the service provider to pipeline users and consumers. PIAC suggests that the AEMC should explore ways to promote the use of the speculative capital expenditure account by service providers for their speculative investment.

Recommendation 14

PIAC recommends that the AEMC considers how to incentivise service providers to use the speculative capital expenditure account for capital expenditure that is of a speculative nature.

7B) Should the regulatory framework support more or less investment of a speculative nature? If more, how could it do so most efficiently and effectively? With which party(s) should the risk of speculative investments reside?

PIAC does not consider it the role of the regulatory framework to explicitly support more speculative investment. If speculative investment is desirable for service providers, the framework

should facilitate it, however, the risk should always reside with the investor. It is unlikely to ever be in the long-term interest of consumers to expect existing pipeline users and consumers to carry the risk for speculative investment on the part of service providers.

Recommendation...

PIAC recommends that the risk of speculative investment should always reside with the investing service provider.

7C) If the regulatory framework permits speculative investment, should it also allow for the management of redundant assets?

Any framework allowing for the management of redundant assets should operate on the same principle PIAC proposes for speculative investment: pipeline users and consumers should never hold the risk for such investment.

Recommendation 15

PIAC recommends that any framework allowing for the management of redundant assets should not have the effect of passing the risk associated with speculative investments to pipeline users and consumers.

Question 8: Capacity available under an access arrangement

8A) Does the current regulatory framework offer appropriate incentives for a service provider to offer spare capacity of a covered pipeline where it is appropriate to do so?

8B) Do you think that scheme pipeline service providers maintain useful spare capacity registers? Does this rule need to be amended in light of expected market reforms?

8C) Are the rules on defining a service provider interacting with ownership and operation structures in a way that impacts on disclosure of potentially available pipeline capacity?

Capacity availability issues are being considered by COAG Energy Council's Gas Market Reform Group.²⁷ PIAC considers that to have been the best forum for assessing current and future arrangements for capacity and suggests that the AEMC use for the results of that report to assess capacity issues in this review.

Recommendation 16

PIAC recommends that the AEMC consider the outcomes of the Gas Market Reform Group's work in their assessment of capacity issues in this review.

²⁷ GRMG, Operation and Administration of the Transpiration Capacity Trading Platform(s) and Day-Ahead Auction, Final Recommendations, June 2017, Canberra.

Question 9: Extensions to the pipeline

9A) Does the ability of service providers to exclude extensions from an access arrangement raise concerns for pipeline users?

PIAC supports the exclusion of pipeline extensions from access arrangements. PIAC considers that this is an appropriate way of excluding speculative investment from a service providers' regulated asset base and therefore of excluding the costs associated with speculative expansions from the revenue recovered from users of the covered pipeline. PIAC contends that service providers, not existing users, should hold the risk when pipelines are extended. PIAC is particularly concerned about this practice in distribution pipelines, where consumers are directly connected to the network.

Recommendation 17

PIAC recommends that the AEMC consider the coverage of pipeline extensions in the context of the risk associated with speculative investment by service operators.

9B) Would service providers and users benefit from the NGR including a negotiation framework for the connection of separately owned assets to covered pipelines?

PIAC has not formed a view on this issue.

Question 10: Performance indicators

10A) Do the requirements to provide key performance indicators as part of an access arrangement result in useful information to users and prospective users of a pipeline?

PIAC does not consider the provision of key performance indicators (KPIs) as part of an access arrangement to be particularly useful. While PIAC generally supports rules requiring the provision of information by service providers, KPI reporting is neither clear nor the appropriate means of reporting. In its current form, the requirement for operators of covered pipelines to report KPIs under rule 72(1)(f) of the NGR states that an access arrangement proposal must include:

the key performance indicators to be used by the service provider to support expenditure to be incurred over the *access arrangement period*.²⁸

This definition is not sufficiently specific. Because the rule does not prescribe what type of information should be reported as a KPI, or how each measure is defined, access arrangements for comparable pipelines can list completely different KPIs. This makes it very difficult for users and prospective users to compare such pipelines. Therefore, the current KPI arrangements do not result in useful information to users and prospective users of a pipeline.

Further, for covered pipelines, the AER already collects performance information through the regulatory information notices (RINs). Unlike KPI reporting, the RIN process is highly prescriptive

²⁸ NGR, Rule 72(1)(f)

in what information it collects²⁹ and, the information reported as KPIs tends to be a duplicate of what is reported through the RIN process. For example, Jemena Gas Network's 2015-2020 access arrangement included two KPIs: operating cost per metre of pipeline and operating cost per customer site.³⁰ While it is important that this information is reported, it is the sort of information that is regularly captured through RINs. That the practical outcome of KPI reporting is merely that RIN information is duplicated suggests that KPI reporting in access arrangements does not result in useful additional information to users and prospective users of pipelines.

10B) Should the rules allow for the regulator to be more specific on which key performance indicators for distribution and transmission should be reported? Would this provide for better comparisons across pipelines and over time? If not, how could greater consistency be achieved?

As outlined in response to Question 10A, PIAC considers the reporting of KPIs to add little value to an access arrangement for a covered pipeline. While PIAC agrees that allowing the AER to be more specific about which KPIs are to be reported for pipelines would provide for better comparisons, such reporting of KPIs would still be a duplication of information that is collected through the RIN process. As such, any attention on redefining reporting standards should be focussed on the RIN.

Recommendation 18

PIAC recommends that the AEMC consider removing KPI reporting as part of access arrangements given that it does not result in useful additional information being provided.

Question 11: Purpose and definition of reference services

11A) Is the purpose of a reference service as an aid to negotiation for pipeline services a relevant purpose for both transmission and distribution pipelines? Has this been a successful approach? Should access arrangements cover a broader range of services?

PIAC considers the reference service approach to have been relatively successful. However, there are concerns about consistency of definitions between pipelines. While PIAC supports a flexible framework that allows for innovative operators to provide new services, it is not desirable to have different pipelines defining very similar services in different ways. This diminishes the ability of users and potential users of pipelines to compare pipelines and therefore contributes to the information asymmetry the ACCC and Dr Vertigan have considered to be a barrier to good outcomes for these users.³¹ PIAC suggests that the AEMC examine the extent to which this could be rectified so that, where possible, reference service definitions are consistent across different pipelines.

²⁹ AER, *Explanatory Statement: Final regulatory information notices to collect information for category analysis*, March 2014, Melbourne, <<https://www.aer.gov.au/system/files/AER%20explanatory%20statement%20-%20final%20category%20analysis%20RINs.pdf>>.

³⁰ Jemena Gas Network, *2015-20 Access Arrangement Information*, June 2014, 30, <<https://www.aer.gov.au/system/files/Jemena%20Gas%20Networks%20-%202015%20Access%20Arrangement%20Information%20-%20PUBLIC.pdf>>.

³¹ ACCC, *Inquiry into the east coast gas market*, 18; COAG Energy Council, *Examination of the current test for regulation of gas pipelines*, 12.

Recommendation 19

PIAC recommends that the AEMC examine how to increase consistency in reference service definitions across different pipelines.

11B) Should reference services continue to be defined in relation to market demand? Is there a more appropriate approach to defining reference services?

In its east coast gas inquiry, the ACCC found that current definition of reference services does not prevent the abuse of market power in services that are not demanded by a significant part of the market.³² PIAC concurs with this finding. As the ACCC notes, services that are not demanded by large parts of the market may also not be contestable. Therefore, the customers that do seek these services find them unregulated and uncontested, leaving them vulnerable to monopoly pricing. Thus, the link between market demand and the definition of reference services directly contributes to inefficient outcomes in the gas pipelines. As discussed in response to Question 1, the centrality of pipelines to the gas supply chain means that inefficient pipeline pricing directly contributes to poor consumer outcomes. Given the commitment to long-term consumer interests that is expressed through the NGO, PIAC contends that this is not a positive outcome from the current reference service framework.

In PIAC's view the AEMC should consider the implementation of a new approach to defining reference services. PIAC concurs with the ACCC that non-contestable services should be a primary target for regulation.³³ This is because they are the services where, due to a lack of effective competition, service providers have the most opportunity to exercise market power. As such, reference services should be defined as those where there is a reasonable expectation that a service provider may be able to exercise market power. In practice, it is likely that reference services would be those where there is a reasonable expectation that they will not be contestable.

Recommendation 20

PIAC recommends that the AEMC consider the implementation of a market power reference service definition in order to prevent monopoly pricing of pipeline services that do not meet the current market demand definition.

11C) Does the access arrangement process limit the ability of the regulator and the service provider to make changes to the reference services for an access arrangement? If so, how can this be resolved? Is there merit in adopting the framework approach process for access arrangements?

PIAC considers the framework and approach (F&A) paper process to be an excellent feature of electricity revenue proposals for regulated assets. F&A papers allow the AER and service providers to negotiate the definition of services to be regulated before the bulk of the regulatory process commences, as well as the form of price control to apply for the regulatory period.

PIAC contends that it would be beneficial to add F&As to the start of the access arrangement process for covered pipelines. Currently, service providers define their reference services during the main access arrangement proposals. Given that the AEMC understands that this creates

³² ACCC, Inquiry into the east coast gas market, 134-135.

³³ Ibid, 135.

difficulties for the AER in contesting or expanding these definitions due to time constraints,³⁴ it is entirely reasonable for them to be given more time to do so outside of the main access arrangement process.

The AER having increased ability to engage with reference service definitions would be a positive outcome for consumers. Through the F&A process, the AER would be able to both broaden the number of services to be regulated for any given pipeline and increase the consistency in definitions across different pipelines.

In conversation with other stakeholders, a key issue PIAC has identified with reference service definitions is the potential for them vary considerably from one pipeline to another. This makes it difficult for pipeline users to compare pipelines and increases the information asymmetry they experience in negotiations. This leads to poor consumer outcomes through less efficiently priced pipeline contracts, which eventually flow through to consumer bills. If the AER were able to push for more consistent reference service definitions through rigorous F&A processes, consumers would have improved outcomes in this respect.

Recommendation 21

PIAC recommends that the AEMC implement a framework and approach process for access arrangements.

Question 12: Light regulation and limited access arrangements

12A) Does the light regulation regime achieve its objectives of providing relevant information to users and prospective users on access to a pipeline?

12B) Should the information reporting requirements and the limited access arrangement provisions for light regulation be amended to better achieve the regime's purpose?

PIAC considers the light regulation regime to have been relatively successful in providing relevant information, albeit in a limited scope. While no service provider has submitted a limited access arrangement,³⁵ the requirement under Rule 36 for lightly regulated pipeline prices and other terms to be published on a web-site works as a tool for informing users and potential users.

However, PIAC is concerned about the scope of this information. It appears that the services listed on web-sites are generally limited to firm forward haul services.³⁶ Given the changing nature of the east coast gas market, this may no longer provide adequate protection for users and prospective users against the market power of pipeline service providers. Therefore, PIAC contends that the light regulation and limited access arrangement provisions may need to be tightened to ensure all services that should be regulated are.

³⁴ AEMC, Review into the scope of economic regulation applied to covered pipelines, 54.

³⁵ Ibid, 55.

³⁶ For example, see: APA Group, *Central West Pipeline, Indicative Terms and Conditions of Access and Rates*, 3, <<https://www.apa.com.au/globalassets/documents/regulatory/east-coast-pipelines/cwp-apa-indicative-light-regulation-tcs-for-national-gas-rules---central-west-pipeline.pdf>>.

Recommendation 22

PIAC recommends that the AEMC use this review to investigate how a broader range of pipeline services could be captured under the light regulation regime.

Question 13: Providing information

13A) Do access arrangements and access arrangement information documents contain relevant information to users and prospective users on access to a pipeline?

13B) Do the Part 11 information requirements result in the provision of information that is relevant to users and prospective users seeking access to a covered pipeline?

PIAC considers both access arrangements and access arrangement information documents to contain relevant information to users and prospective users on access to a pipeline. The NGR information requirements in Part 11 requires information to be published about capacity, tariffs and responses to access requests for scheme pipelines, all of which PIAC considers relevant and useful.

Part 8 provides similar requirements (other than price) for limited access arrangements (light regulation). The rule requirements for non-scheme pipeline operators to provide relevant public information appears to be far less clear.³⁷

While PIAC is comfortable with NGR information provision requirements, concerns remain about the clarity and consistency of the information that is actually provided in the access arrangement process particularly for those pipelines not subject to full coverage. If information is not presented in a consistent manner across different pipelines and their access arrangements documentation, it makes it difficult for users and prospective users of a pipeline to negotiate.

Recommendation 23

PIAC recommends that the AEMC investigate how a broader range of pipeline services could be captured under the light regulation regime.

13C) Could the Bulletin Board, or the scheme register, play a greater role in making available information regarding covered pipelines?

PIAC considers the Bulletin Board (BB) to be an important mechanism for providing information about the east coast gas market. As the AEMC notes, some covered pipelines will also be BB pipelines.³⁸ Given the proposed expansion of BB coverage in the AEMC's current BB rule change process, this overlap will presumably become more common in the near future.³⁹ The AEMC should therefore take the opportunity presented by this review to consider how information

³⁷ For instance, APA publishes "Indicative prices" and "Gas Transportation Agreement Standard Terms and Conditions" (a 92 page document) on their web-site along with a standardised "User Access Request" (see <https://www.apa.com.au/our-services/gas-transmission/gas-transmission-services/>) which together cover many of the same areas but where definitions of services may be quite different from other pipelines.

³⁸ AEMC, Review into the scope of economic regulation applied to covered pipelines, 56.

³⁹ AEMC, Improvements to Natural Gas Bulletin Board, June 2017, <<http://www.aemc.gov.au/Rule-Changes/Improvements-to-Natural-Gas-Bulletin-Board>>.

reporting could be rationalised for covered pipelines and if the BB could play a role in access arrangement information provision.

Recommendation 24

PIAC recommends that the AEMC identify how the Bulletin Board could be used to support access arrangement information provision.

Question 14: Arbitration

14A) If there is uncertainty about how the current arbitration framework operates, how could this be resolved? Should Chapter 6 of the NGL and/or Part 12 of the NGR be amended with regards to the information and/or the processes?

PIAC has not formed a view on this issue.

14B) Are there aspects of the arbitration framework for non-scheme pipelines under development by the GMRG that could also apply to scheme pipelines?

While PIAC does not have firm views on which GRMG recommendations should also apply to scheme pipelines, PIAC is of the view that the AEMC should identify if such a relationship exists.

14C) Which pipeline services should be subject to arbitration? Are there any pipeline services that should be excluded?

Arbitration is a key protection for pipeline users, and therefore consumers, against the use of market power of pipeline service operators. Given the growing complexity of pipeline services beyond firm forward haul, and their importance to an efficient east coast gas market, the arbitration mechanism for covered pipelines should be as broad as possible. For both full and light regulated pipelines, the arbitration mechanism should address all widely used services and be able to adapt as additional pipeline services come on stream.

Recommendation 25

PIAC recommends that all services provided through covered pipelines should be subject to arbitration as far as practicable.

Question 15: Tariffs

15A) Do you consider that the reference tariffs for transmission and/or distribution pipelines reflect the efficient costs of providing those reference services? If not, which provisions of the NGL or the NGR are contributing to this outcome?

Despite recent reforms to encourage them to do so, reference tariffs for covered pipelines have not consistently reflected the efficient costs of providing reference services. While recent AER decisions have reduced operating and capital expenditure allowances relative to pre-2013 levels, there are still multiple disputes between the AER and service providers over the AER's use of benchmarking to establish efficient costs along with its treatment of rate of return, taxation, depreciation and inflation.

In PIAC's view, the final regulatory decisions have often resulted in higher-than-efficient cost recovery through reference tariffs. In many cases, this is likely to be driven in large part by the prospect of appeals and information and resource asymmetry as the networks are able to bring substantial resources to the formulation of their proposals and the presentation of these to the Tribunal and courts. In many areas, therefore, the final decisions on expenditure and rate of return do not represent the efficient costs of a business for this level of risk.

Further, there is a concern from PIAC and other consumer advocates that as the industry becomes increasingly privatised, including substantial foreign holdings, the assumptions about the 'benchmark efficient entity' are no longer relevant. One example of this is the use of Australia's benchmark corporate tax rate of 30% as the basis for calculating taxation costs in the revenue building block. While this may lead to efficient cost recovery for some Australian-owned businesses, foreign-owned pipeline service providers may be paying substantially less than 30% in tax. It is also probable that the relevant cost of capital for these businesses is below the benchmark cost of capital used in the regulatory decision, resulting in distortions in investment incentives as well as excess costs to customers.

PIAC acknowledges that the AER has recently initiated two extensive review programs. These programs will consider issues around the treatment of inflation and to develop a new guideline for rate of return assessments.⁴⁰ The AEMC should keep these processes in mind when considering reference tariffs in this review.

Recommendation 26

PIAC recommends that the AEMC use this review to consider if, and why, the AER, and/or ACT tends to approve higher-than-efficient cost recovery through reference tariffs.

Recommendation 27

PIAC recommends that the AEMC consider tariff issues in the context of AER inflation and rate of return review processes.

15B) Should the NGR recognise partially covered pipelines and provide specific guidance on cost allocation in this context?

The NGR should recognise partial covered pipelines and develop appropriate cost allocation methodologies. In general, PIAC contends that these methodologies should include comparable cost assessment processes for the covered and non-covered sections of a pipeline. When assessing costs for the non-covered section, it is preferable for the AER to know there is a common approach to depreciation of assets, the treatment of tax and allocation between operating and capital expenses and to overhead cost allocations. Similarly, while there may be a need for a different assessment of risk, the rate of return on capital for the covered and non-covered sections of a pipeline should be calculated using a comparable approach.

PIAC acknowledges that the assessment of costs for the purposes of allocation of total costs between covered and uncovered services is made more complex because the AER's regulatory

⁴⁰ AER, Review of expected inflation 2017, 2017, <<https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/review-of-expected-inflation-2017>>; AER, Review of rate of return guideline, 2017, <<https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/review-of-rate-of-return-guideline>>.

incentive based framework for covered pipelines. This is because it relies on a suite of objectives, principles, factors and benchmarks to establish the various costs in the revenue building blocks. In other words, the AER does not seek to make its decision on the basis of actual costs but also to identify actual costs and allocate these, but to identify efficient costs for the benchmark efficient network business. These benchmark efficient costs may be quite different to actual costs. If a service providers' costs to provide regulated services are in excess of the efficient costs, and regulated revenue relies on the AER's assessment of efficient costs, then this will impact on the costs notionally allocated to supply the non-regulated services.

Despite this complication, PIAC considers it appropriate that the AEMC considers how the NGR could recognise partially covered pipelines and provide specific guidance on consistent cost allocation methodologies across and between covered and non-covered sections of such pipelines.

Recommendation 28

PIAC recommends that the AEMC consider how the NGR could recognise partially covered pipelines and provide specific guidance on consistent cost allocation methodologies across covered and non-covered sections of such pipelines.

15C) Do the tariff setting requirements in the NGR provide appropriate balance between discretion and guidance to achieve cost reflective tariffs? Should the discretion of the regulator be limited?

15D) Why do you think that distribution pipeline service providers tend to charge reference tariffs as the prices for the services that they provide?

PIAC as not formed views on these issues.

15E) Is the balance between prescription and discretion for the reference tariff variation appropriate? Would more guidance from the NGR or from the regulator better support the development of these mechanisms?

PIAC contends that the AER should continue to have full discretion over tariff variation. The approach in the gas rules to the tariff variation mechanism is quite different to that required of electricity networks, where the mechanism is determined by the AER and set out prior to the network's regulatory proposal in the F&A document. As noted in response to Question 11C, PIAC supports the introduction of the F&A process for access arrangements. This process allows the AER to adopt a consistent approach that reflects policy principles and specific risks to consumers. For example, the AER has moved all electricity networks to a revenue cap form of price control (after 2013) following observations that the average price control mechanism resulted in consistent over-recovery by the networks relative to the allowed revenue. This change also had the effect of transferring volume risk to consumers over the course of the regulatory period. Such a trade-off that is best assessed against the NEO/NGO by the AER in consultation with stakeholders, rather than by individual networks with limited discretion available to the AER as occurs in the current gas access arrangements. For this reason, PIAC supports the introduction of an F&A to the gas access arrangement process to support tariff variation decisions on the form of revenue/price control and on the side constraints that apply to changes in prices for any tariff group.

Recommendation 29

PIAC recommends that the AER continue to have full discretion over tariff variation.

Recommendation 30

PIAC recommends that the AEMC consider the introduction of a framework and approach process for access arrangements to support consistent tariff variation decision-making across all pipelines.

Question 16: Non-tariffs conditions

16A) Do the non-tariff requirements for access arrangements result in relevant information being provided to users and prospective users of covered pipelines? Are there other non-tariff requirements that would be relevant?

16B) Should the NGR or the regulatory provide more guidance of which non-tariff requirements should be included in an access arrangement? Is there need to provide greater guidance regarding the regulator's assessment of no-tariff requirements?

PIAC as not formed views on these issues.

Further engagement

PIAC would welcome the opportunity to discuss the issues considered herein in more depth. For any queries please contact Energy Team Leader, Craig Memery at cmemery@piac.asn.au or on (02) 8898 6522.

Appendix A: PIAC submission to the Vertigan coverage test review

Introduction

PIAC welcomes the opportunity to respond to Dr Michael Vertigan's (AC) consultation paper, *Examination of the current test for the regulation of gas pipelines*, prepared for the Council of Australian Governments Energy Council (Energy Council).⁴¹ This consultation comes at a critical point for Australia's energy system and has implications beyond gas pipeline regulation.

The recent Australian Competition and Consumer Commission (ACCC) review of the East Coast Gas market recommended that the test to determine coverage of gas pipelines be reviewed to ensure it is fit for purpose in a changing gas market. The Energy Council asked Dr Vertigan to lead the review.

PIAC supports the recommendations put forward by the ACCC and is pleased that the Energy Council is progressing the issue.

Current test

Economic coverage of gas pipelines is assessed by the National Competition Council (NCC) and determined by the relevant Minister in accordance with section 15 of the National Gas Law (NGL).

The section states:

- (a) that access (or increased access) to pipeline services provided by means of the pipeline would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the pipeline services provided by means of the pipeline;
- (b) that it would be uneconomic for anyone to develop another pipeline to provide the pipeline services provided by means of the pipeline;
- (c) that access (or increased access) to the pipeline services provided by means of the pipeline can be provided without undue risk to human health or safety; and
- (d) that access (or increased access) to the pipeline services provided by means of the pipeline would not be contrary to the public interest.⁴²

The question at the centre of this review is whether the current test is effective in dealing with the market failure of monopoly pricing. Gas pipelines are natural monopolies, and gas producers and consumers are required to use individual pipelines to transport gas. This provides an opportunity for the pipeline owners to charge monopoly prices for access to capacity regardless of the impact on competition upstream or downstream. The test, particularly subsection (a), does not address this issue as it is only used to determine if access will produce an increase in competition. From a

⁴¹ Dr Michael Vertigan (AC) *Examination of the current test for the regulation of gas pipelines* Consultation paper, 4 October 2016.

⁴² National Gas (South Australia) Act 2008—30.1.2015 Schedule—National Gas Law Chapter 1—Preliminary Part 1—Citation and interpretation, 54.

consumer perspective, the key market failure to be addressed is that of excessive market power. PIAC considers that the ACCC assessment is correct and that the test should be amended so that it explicitly addresses the issue of excessive market power.

Consultation

Before addressing the substance of the consultation paper, PIAC would like to comment on the consultation process. PIAC is disappointed with the limited time that has been provided to stakeholders to make submissions. PIAC considers that the tight timeframe makes it difficult for consumer organisations to collect and analyse the information needed to produce an effective submission.

PIAC has previously submitted to the Energy Council on the importance of meaningful consumer consultation.⁴³ Because of the significant resource imbalance between consumer organisations and industry, it is particularly important for governance institutions to provide additional support and information to enable consumer organisations to participate in consultation processes.⁴⁴

In PIAC's view, the National Gas Objective (NGO) and the National Electricity Objective (NEO) and their location within a broader legislative scheme which privileges the interests of consumers, demonstrates the vital role that consumer consultation is intended to play in decision-making in the NEM.

Given the critical role that gas in Australia's energy mix, PIAC believes it is vital that consumers participate and are heard in this consultation.

What is the problem and why does it need addressing?

Impact of gas pipeline regulation on consumers

The NGO places the consumer at the centre of energy system decision-making. Gas supply is an essential service that is provided by monopoly businesses. There is a strong case that such services should be regulated.

The cost of gas is increasing in Australia for both residential and business consumers. This has led to an increasing number of households with gas debt, which in some states is greater than the number of households with electricity debt.⁴⁵ PIAC understands that gas prices are influenced by a number of factors, including wholesale gas prices and transmission and distribution charges.

Given there is evidence of monopoly pricing and an opaque gas market, PIAC considers that consumers will benefit from the greater transparency and accountability that would come from improvements in regulation and amendments to the test for pipeline coverage. This is particularly important in a context where the coverage of some distribution pipelines has been reviewed and changed to light regulation. A claim made during one review was that the costs saved as a result of pipeline owners no longer needing to comply with full regulation would be passed onto consumers. Once a decision to revoke coverage or change the level of regulation has been

⁴³ PIAC *From complex fragments to competitive consumer-focused markets* Submission in response to Review of Governance Arrangements for Australian Energy Markets: Issues Paper, 7 May 2015.

⁴⁴ Ibid 38.

⁴⁵ AER, 2015-16 Q3 Residential customers with an energy debt - by jurisdiction, <https://www.aer.gov.au/retail-markets/retail-statistics/2015-16-q3-residential-customers-with-an-energy-debt-by-jurisdiction>

made, however, it is difficult for consumers to determine what effect it has on subsequent pipeline pricing. PIAC recommends a review of light coverage decisions in gas pipelines to determine whether they have led to subsequent reductions in pipeline charges for consumers.

Industry claims that gas is a fuel of choice, and therefore subject to competitive pressures from electricity. For many consumers, this is simply not the case. For some consumers, for example, the cost of changing household appliances from gas to electricity may be too high, while for renters it is a decision they cannot make. For households that only use gas for cooking and hot water, the fixed service charge is a greater portion of their bills, and it is estimated that dual fuel customers pay up to \$900 a year in fixed charges, with gas supply charges for some networks approximately 54% of the bill.⁴⁶ These customers, that remain connected to gas because of inability to switch, will be the most affected by the consequences of any changes to the economic coverage of pipelines.

The fourth criterion in the current test under section 15 is a public interest test that is drafted in the negative, i.e. where 'granting access would *not be* in the public interest'. The primary considerations that are taken into account in determining the public interest are those of economic efficiency, regulatory costs and investment effects. PIAC considers that these factors are too narrow, and not in line with the NGO or the Energy Council's preferred risk-based approach, which seeks to identify any matter that could make access (or increased access) contrary to the public interest and then assess whether the likelihood and consequences of the matter lead to a conclusion that access is contrary to the public interest.⁴⁷

The level of information provided should be a key factor in determining the public interest, so that shippers are able to negotiate pricing on uncovered pipelines. If there is not sufficient information, then that should be considered as contrary to the public interest.

Additionally, an applicant should have to prove that revoking coverage is in the public interest rather than proving that the revocation is not contrary to the public interest.

Distribution networks

PIAC considers it relevant to consider recent decisions with regard to the regulation of distribution pipelines. These include changes to light regulation for Brisbane gas distribution pipelines and the removal of coverage for the Wagga Wagga pipeline. PIAC is particularly concerned that the Wagga Wagga pipeline no longer has coverage. PIAC does not consider that retail gas competition is sufficient to provide the competitive pressure as is required by Section 15(a). Under a reworked market power test, the decision may have been to keep the pipeline covered.

In regional areas, such as regional NSW, efforts to promote retail competition have not resulted in an increase in retailers or gas offers available.⁴⁸ This, combined with evidence of monopoly pricing in some of the regional pipelines as well as the larger pipelines,⁴⁹ leads to concerns that regional gas customers are being charged more than the efficient cost of providing that service.

⁴⁶ St Vincent de Paul Society, Queensland Energy Prices July 2016: An update report on the Queensland tariff-tracking project, 2016, 21-23.

⁴⁷ National Competition Council, Gas Guide, A guide to the functions and the powers of the National Competition Council under the National Gas Law, Version 1.0, October 2013, 48.

⁴⁸ AEMC, Final Report, *2016 Retail competition review*, 30 June 2016, 20.

⁴⁹ ACCC, Inquiry into the east coast gas market April 2016, 110-111.

Even where pipelines are not charging monopoly prices, the evidence suggests that tariffs charged are higher than they would be if those pipelines were covered by regulation.⁵⁰

The reason given for changing the coverage of the Brisbane distribution pipeline is the decline in residential gas demand. The Council, therefore, decided that there would be no incentive for the gas pipeline owner to charge excessive prices. The ACCC found, however, that another pipeline owner (not the owner of the Brisbane pipeline) that they assessed with decreasing gas demand did actually increase their prices.⁵¹ In light of this finding, PIAC is concerned that a potential 'death spiral' and asset write offs for unregulated pipelines will put customers at risk of higher prices. Consumers are not able to challenge prices due to the burden of providing proof in the arbitration process left under a light regulation.

Recommendation 1

PIAC recommends that a review of past light coverage decisions be conducted to determine if the decisions have resulted in reduced pipeline charges for end consumers.

Competition between gas and electricity

Most coverage decisions are determined under Section 15(a), on the basis that access will lead to increased competition. This appears to be done on the assumption that competition is the same as efficiency. Monopoly pricing can result in prices being charged that are not based on the efficient costs of business, and improvements in efficiency can be driven by factors other than competition.⁵² Even where there are conditions for competition, the ACCC found evidence of monopoly pricing.

Denial of access is a separate issue from monopoly pricing. A transmission pipeline owner can allow access at a non-discriminatory price to all shippers/market participants, while still charging all parties a price in excess of the efficient price that would prevail in the absence of a monopoly.

Where the owner of the "essential facility" is not competing in up stream or downstream markets, the owner of the facility will usually have little incentive to deny access, for maximising competition in vertically related markets maximizes its own profits. Like other monopolists, however, the owner of the facility is able to use its monopoly position to charge higher prices and derive monopoly profits at the expense of consumers and economic efficiency. In these circumstances, the question of "access pricing" is substantially similar to the monopoly pricing issues, and maybe subject, where appropriate, to the prices monitoring or surveillance process.⁵³

Professor Hilmer made these comments in his early competition reviews and found that where there are vertical interests, there is a need for access regulation. Part IIIA of the *Competition and Consumer Act 2010* (Cth) (CCA) was designed to address this. However, Hilmer also noted that natural monopolies can exist in one section of the value chain within a vertically integrated market and suggested that price regulation should occur in these instances.

⁵⁰ Ibid 123-124.

⁵¹ Ibid 99 & 104.

⁵² Castalia Strategic Advisers, *AMEC gas access regime advice*. 10 August 2015, 11.

⁵³ Prof Frederick C Hilmer, National competition policy review, 25 August 1993, 241.

The ACCC found that competition from other energy sources does not constrain pipeline prices and the threat of regulation is not sufficient to deter monopoly pricing and use of market power.⁵⁴ Gas is not always fungible and to therefore to say that, because electricity exists it necessarily provides a competitive force for gas, is false. The ACCC also found that as a result of recent changes in the east coast gas market, competition between pipelines has decreased to the point that pipeline owners do not see other pipelines as competitors.⁵⁵ This is in part due to changes in the direction of flow around the market. Finally, gas pipelines are a bottleneck in the supply chain, and so even if there was effective competition in either the upstream or downstream market, producers and shippers are still required to use a single pipeline to transport gas. Even in a disaggregated market, this bottleneck remains.

As discussed above, gas has become an integral part in the energy supply system providing gas fired generation including system stabilisation, and restart generation in the event of a black start. The nature of gas supply in the electricity market is intermittent and therefore access to pipeline capacity is infrequent, making gas fired generation more susceptible to monopoly pricing, having a knock-on effect in the electricity spot market.

In countries with greater levels of competition between pipelines, such as the United States, the majority of pipelines are regulated; particularly those that cross state boundaries. The United States has a market power test and it is up to the pipeline owner to prove that they do not have excessive market power. PIAC recommends that if a market power test is adopted in Australia, a similar approach to proving that owners do not have excessive market power be adopted.

Recommendation 2

PIAC recommends that if a market power test is adopted then the onus to prove market power must be with the pipeline owners.

Is the existing regulatory test working?

PIAC relies on the information and analysis provided by the ACCC. The ACCC has had access to confidential information about the nature of pipeline contracts including the prices charged for various transmission services and the costs to a transmission pipeline to provide these different services.

The ACCC found substantial returns on equity for a number of pipeline owners, including owners of critical interstate transmission pipelines, above those that would be allowed under a regulated access agreement. Since the release of the ACCC's report, the Australian Pipeline Authority (APA) stated that the ACCC only included rate of return data for pipeline expansions or alterations to provide bi-directional flows and that by only analysing this data the rates of return had been inflated.⁵⁶

PIAC is concerned that even if the APA's contention is correct, consumers may still be paying higher than efficient pricing due to the nature of the NGL, which only applies coverage to a reference service, which may only be one service, provided by the pipeline. Given the growing

⁵⁴ ACCC see above no 49, 99-100.

⁵⁵ Ibid 98.

⁵⁶ APA Group Media Statement, Gas pipelines investing and innovation for gas markets, response to the ACCC east coast gas inquiry report. 20 May 2016, 2.

complexity and interregional links in the east coast pipeline network, there are an increasing range of important services provided by pipelines including back-haul, park and loan, and interruptible, and as available capacity, they remain unregulated and may be subject to monopoly pricing.

Impact of monopoly pricing

The ACCC clearly outlines the impact of monopoly pricing. Its analysis, however, does not consider the second-order impacts on the energy market. Access to the additional services listed above is critical for variable gas fired power generation, particularly for generators that provide stand-by power, and any monopoly pricing here will have an impact on electricity prices.

Demand management services reduce costs in the energy system. The efficiency of demand management will be reduced if monopoly pricing occurs, as it will impact the efficient costs of market players who provide back-up cogeneration facilities. Additionally, larger shippers and retailers are able to spread extra costs from the presence of monopoly pricing across their portfolio. Monopoly pricing of transmission services, even if not overtly discriminatory, compounds the risks facing new entrants in both upstream and downstream markets. This is particularly concerning for regional retail gas consumers where competition has not significantly improved despite the removal of price regulation.

Victorian Declared Wholesale Gas Market reforms

The proposed reforms for the Victorian Declared Wholesale Gas Market (VWGM) include moving to an entry-exit system. Under the current regulatory arrangements the AER approves the pipeline owner and system operator (AEMO) charges. It is unclear if under the proposed changes the declared transmission system (DTS) would remain covered. Under the current test any application to remove coverage would likely succeed as there are other transmission pipelines supplying gas to and from Victoria. It would also be difficult to mount an access discrimination case, that the removal of coverage would reduce competition in either the upstream or downstream markets, given the current interpretation of the NGL and previous decisions. A market power test, however, may be more likely to see coverage remain on the DTS. The Victorian gas market serves as an important market in not just Victoria but the east coast.

Revoking and recovering pipelines

The removal of coverage from a pipeline requires the satisfaction of only one of the four criteria, and most decisions have been determined by the satisfaction of the first. Often the burden of proof lies with those opposing the removal of coverage. This is extremely difficult, given the nature of the confidential information involved, and the difficulty of proving an impact on upstream or downstream competition, as the market is no longer vertically integrated.

There have been few attempts to have a pipeline recovered by regulation and those attempts have failed. This is in part because an application to recover a pipeline must satisfy all four criteria. While it is technically possible for anyone to lodge an application, the financial and legal resources required make it practically impossible for consumers to lodge an application.

This was evident when Kimberley Clarke sought to have coverage reapplied to the South East Pipeline System (SEPS). Initially SEPS pipeline was covered when the NGL was introduced. Coverage was removed in 2000 after the owner applied to have it removed based on the costs of regulation and because capacity was under contracted. It was argued that the owner did not have

any incentive to charge high prices. Once the long-term contract underpinning the pipeline expired in 2010, the owner increased the charges to access the pipeline. In order to apply to recover the pipeline, the applicant had to prove not only that the pipeline was a monopoly, the reason it was originally covered, but had to also satisfy all four criteria. Ultimately the decision was made that the applicant was not able to prove that coverage would improve competition. The main users of the pipeline are price takers in their markets and could not prove there would be sufficient increase in upstream gas production.⁵⁷ If residential consumers wanted to seek to have the Wagga Wagga pipe recovered it would be nearly impossible for them to participate and to prove the criteria was satisfied.

Decisions by the NCC and relevant Minister are complex and legalistic. Regardless of whether the test is changed, it should be a requirement that the NCC publish summaries of its decisions in a clear, simple and accessible manner that consumers are able to understand. Ensuring the decisions are accessible is the first step in ensuring consumers can participate in reviewing decisions.

Recommendation 3

PIAC recommends that coverage decisions should be published in accessible, plain English to assist consumers to understand and participate in reviews.

How could the regulatory test be improved?

There are two options for reforming the current test; the first is to accept the recent competition review recommendations to amend the CCA and subsequently the NGL; and the second is to move to a market power test as proposed by the ACCC.

Current reform agenda

The Harper review recommended changes to section 46 of the CCA which address misuse of market power and include changes to the declaration criteria (the general access test that the NGL access test is mirrored on). Some stakeholders have proposed that these changes alone will be enough to address concerns about the provisions of the NGL not being fit for purpose.

The role of section 46 is to distinguish competitive activity that is desirable from economically inefficient and monopolistic practices that may exclude rivals and harm competition. There are three criteria used to determine this:

- corporations that have a substantial degree of power in a market;
- from taking advantage of that power;
- for the purpose of eliminating or substantially damaging a competitor, preventing the entry of a person into a market, or deterring or preventing a person from engaging in competitive conduct.⁵⁸

Harper proposed:

- to maintain the substantial market power threshold test
- remove the 'take advantage' test

⁵⁷ Major Energy Users, *A Review of Gas Pipeline Competition, Issues where there is a lack of open access and Limited or no competition*, 2015, 7-8.

⁵⁸ Australian Government, 'Options to strengthen the misuse of market power law', (2005), 3.

- introduce an effects test
- move from “damage to a competitor” to “substantially lessening competition”; and
- introduce mandatory non-exhaustive factors that the courts must consider when making decisions.⁵⁹

The most controversial of the recommendations is the introduction of an effects test, which would examine the effect of a firm’s behaviour rather than the purpose of the activity, as the effect is what causes harm to consumers. Proving the (subjective) purpose of commercial conduct is difficult, while proving (objective) effect is less so. The proposed changes are intended to improve the clarity and force, and provide clarity for courts who are reviewing decisions.

The recommendations would result in a reframing that allows the provision to be simplified and would allow the repeal of amendments introduced since 2007, which would become unnecessary. These include ‘specific provisions prohibiting predatory pricing, and amendments clarifying the meaning of ‘take advantage’ and how the causal link between the substantial degree of market power and anti-competitive purpose may be determined’.⁶⁰ The Federal government has accepted all of the Harper review recommendations in its Exposure Draft Bill.⁶¹

Finally, the Harper Review examined the National Access Regime and made the following recommendations:

- Criterion (a) should focus on the specific effect of declaration, rather than access, on promoting competition in dependant markets.
- Criterion (a) currently sets a low threshold for regulation (“material increase”), which should be raised (“substantial increase”).
- Criterion (b) currently asks whether the facility is a bottleneck in the sense that it is commercially infeasible to bypass the facility. The recommendation retains focus, however but revises the provision to exclude the service provider from the assessment of feasible duplication by anyone.
- Criterion (f) works to strengthen the public interest test, replacing the requirement that access be “not contrary” to public interest, to a requirement that access “promote” instead it.⁶²

The Government has agreed to adopt criterion (a) and (b) as recommended by the 2013 Productivity Commission Review⁶³, and not those suggested by the Harper Review.

Therefore:

- Criterion (a) retains the “material increase” test; and
- Criterion (b) will be satisfied where total foreseeable market demand for the infrastructure service over the declaration period could be met at least cost by the facility. This effectively replaces the current “private profitability” test, with a “natural monopoly” test.

The Government has agreed to adopt criterion (f) as recommended by the Harper Review.

⁵⁹ Professor Ian Harper, *Final Report National competition review*, March 2016, 61 and 335-340.

⁶⁰ Ibid 348.

⁶¹ Exposure Draft of the *Competition and Consumer Amendment (Competition Policy Review) Bill 2016*

⁶² Professor Ian Harper see above no 59, 437.

⁶³ Productivity Commission Inquiry Report, National Access Regime, No. 66, 25 October 2013.

PIAC is disappointed that the government has not adopted the proposed changes from the Harper Review with regard to criteria (a) and (b). PIAC supports the proposed changes to the public interest test (criterion (f) of the access regime and criterion (d) of the NGL).

ACCC recommendations

The ACCC recommended that the current test in the NGL be replaced with a new test that will assess the market power of a pipeline, determine if the pipeline will continue to have substantial market power, and if coverage will or is likely to contribute to the realisation of the NGL.⁶⁴ The ACCC has not provided more detail on the design of a market test, preferring to leave that to either the Australian Energy Market Commission or COAG. The Energy Council has agreed to establish a gas market reform committee, and it is appropriate for this group to be involved, as long as there is sufficient representation of consumers or their advocates.

Since the Government has rejected the Harper Review's recommendation to change criteria (a) and (b), PIAC considers that the ACCC's proposed new test better represents the current market conditions and would deal better with the impact of no coverage on the consumer. This market test would be more in line with the United States, which has greater regulation and competition between pipelines and where pipelines are assumed to have market power from the beginning, and it is up to a pipeline owner to demonstrate they do not have an excess amount.

Requiring pipeline owners to prove they do not have market power will address the current issues the Minster and NCC have in accessing information to make an effective decision.⁶⁵ Two previous reviews of the gas access regime also recommended that the coverage test be changed.⁶⁶ In light of the ACCC recommendation and previous reviews, PIAC recommends that the test for coverage be reformed to better reflect current market conditions.

The ACCC has recommended retaining the 15-year no determination provision for new pipelines to encourage investment in new pipelines.⁶⁷ PIAC does not know that is appropriate and would welcome additional information to understand if it provides incentives for pipeline owners to invest and build new projects and to determine if this is in the public interest. PIAC also acknowledges that many of the current uncovered pipelines will likely remain uncovered with a new test, due to the existence of long-term contracts.⁶⁸ This is another protection in place for pipeline owners, as there is no risk that coverage will immediately change upon the drafting of a new test.

Recommendation 4

PIAC recommends that the review accept the ACCC's recommendation to change the coverage test.

Limited Merits Review review

PIAC has provided input into the current review of the limited merits review (LMR). In our submission, we argue for targeted changes to the LMR framework to protect consumer

⁶⁴ ACCC see above no 49, 138.

⁶⁵ Ibid 139.

⁶⁶ Incenta, Assessment of the coverage criteria for the gas pipeline access regime for the Australian Energy Market Commission, September 2015. And Castalia see above no 52.

⁶⁷ Ibid 137.

⁶⁸ Ibid 139.

interests.⁶⁹ PIAC has the unique perspective of being one of the few consumer organisations to have participated in a LMR. Generally, PIAC is of the view that if changes to the LMR framework result in access for consumers to LMR processes, this will provide consumers greater opportunity to appeal coverage decisions. PIAC's preferred way of dealing with the issues presented in coverage review is to change the coverage test to enable better decisions to be made, rather than relying on changes to the appeal aspect of the process.

Conclusion

PIAC appreciates that compliance with economic regulation has a cost for businesses, and has the potential to pose risks to investment. PIAC considers that the risks and costs are not as extreme as claimed by the pipeline owners, and that there are sufficient protections, including 15-years of no coverage for the construction of a pipeline, to ensure that risks are manageable.

Generally, economic regulation provides certainty for business and investment decision-making and provides transparency and certainty for shippers and consumers.

Industry contends that coverage issues should be left to the power of the market⁷⁰. As energy is an essential service that is necessary to live a dignified life, the risks of market failure in these circumstances are arguably too high:

The most serious mistake we can make is pretending that markets do things that they do not do," said Kellan Fluckiger, executive director of the electricity division at the Alberta Department of Energy. "Markets allocate risk, they allocate capital, they provide price signals. Markets do not have a conscience, they do not provide social policy, and they do not do things they are not paid to do."⁷¹

PIAC supports the conclusions of the ACCC in the recent review of the east coast gas market. Recent changes in the market, in particular the reduction in vertical integration accompanied by an increase in horizontal integration, mean the current test is no longer fit for purpose. PIAC recommends that the test for determining if a pipeline should be covered by economic regulation be changed in line with the ACCC's recommendation.

⁶⁹ PIAC, Paved with good intentions: an assessment of practical outcome against policy intent Submission in response to the COAG Energy Council Review of the Limited Merits Review Regime Consultation Paper, 7 October 2016.

⁷⁰ APA Group, Media Statement: Gas pipelines investing and innovation for gas markets Response to ACC east coast gas inquiry report 4 august 2016, 4.

⁷¹ Matthew L Wald, Experts Assess Deregulation as Factor in '03 Blackout 16 September 2005, <http://www.nytimes.com/2005/09/16/politics/experts-assess-deregulation-as-factor-in-03-blackout.html>