Queensland Access Regime for Gas Pipeline Services

Final Recommendation

November 2002

Application for Certification under Section 44M(2) of the Trade Practices Act 1974

National Competition Council

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Abbreviations and glossary of terms

ACCC	Australian Competition and Consumer Commission
Access arrangement	arrangement for third party access to a pipeline, submitted by a pipeline owner/operator to the regulator for approval under the National Gas Code
Access arrangement information	information made available to enable access seekers to understand the derivation of an access arrangement; submitted to the regulator for approval under s.2 of the National Gas Code
APT	Australian Pipeline Trust Petroleum Pipelines Limited
Council	National Competition Council
CGP	Carpentaria Gas Pipeline (pipeline 41)
clause 6	clause 6 of the Competition Principles Agreement
CPA	Competition Principles Agreement
Derogation	a legislative exemption from compliance with specified obligations in the National Gas Code
Duke	Duke Energy International – Asia Pacific
Epic	Epic Energy Pty Ltd
GPAL	*Gas Pipelines Access Law (South Australia)*
National Gas Code	National Third Party Access Code for Natural Gas Pipeline Systems
NCC	National Competition Council
PC	Productivity Commission
Petroleum Act	*Petroleum Act (Queensland) 1923*
Pipeline 2	Roma (Wallumbilla) to Brisbane pipeline (RBP)
Pipeline 24	South West Queensland Pipeline (SWQP), Ballera to Wallumbilla pipeline
Pipeline 30	Queensland Gas Pipeline (QGP), Wallumbilla to Gladstone via Rockhampton pipeline
Pipeline 41	Carpentaria Gas Pipeline (CGP), Ballera to Mt Isa pipeline
PNG pipeline	Papua New Guinea to Queensland gas pipeline (proposed)

QCA	Queensland Competition Authority
QDME	Queensland Department of Mines and Energy
QGAT	Queensland Gas Appeals Tribunal
QGP	Queensland Gas Pipeline (pipeline 30)
QGPAA	*Gas Pipelines Access (Queensland) Act 1998*
Qld Regime	Queensland Gas Pipelines Access Regime
RBP	Roma to Brisbane pipeline (pipeline 2)
Reference service	a service likely to be sought by a significant part of the market, which is specified in an access arrangement and has a specified reference tariff
Reference tariff	a benchmark price for a reference service, specified in an access arrangement, at which third parties have a right of access
s.	section
s.58 pipelines	pipelines covered by a derogation at s.58 of the QGPAA
SA Gas Access Regime	South Australian Gas Pipelines Access Regime
service	A service provided by a gas pipeline covered by the National Gas Code, including: • haulage services (such as firm haulage, interruptible haulage, spot haulage and backhaul); • the right to interconnect with the Covered Pipeline; and • services ancillary to the provision of such services, • but not including the production, sale or purchasing of Natural Gas.
SWQ	South West Queensland
SWQP	South West Queensland Pipeline (pipeline 24)
TJ	Terajoule (equal to 1,000 GigaJoule)
TPA	Trade Practices Act
1997 Gas Agreement	Natural Gas Pipelines Access Agreement

1 Background and process

The Queensland Government applied to the Council pursuant to section 44M of the *Trade Practices Act 1974* (**TPA**) in September 1998 to recommend on the 'effectiveness' of the State's access regime for gas pipeline services (**Queensland Regime**). If a regime is certified as effective, services subject to the regime cannot be 'declared' for access under Part IIIA of the TPA.

The Queensland Regime[1] applies to spare and developable capacity in Queensland natural gas pipelines covered under the *National Third Party Access Code for Natural Gas Pipeline Systems* (**National Gas Code**). The regime does not apply to foundation contracts or any other pre-existing contractual arrangements.

In considering the Queensland Regime's effectiveness, the Council has applied the principles set out in the relevant clauses of the *Competition Principles Agreement* (**CPA**). The relevant clauses are clauses 6(2) to 6(4) (**clause 6 principles**) of the CPA.[2] To assist its consideration, the Council consulted with stakeholders in 1999 and received a number of submissions, available on the Council's web site at www.ncc.gov.au. Several submissions raised concerns over the implications of substantial derogations embedded in the regime. The Council also requested the Australian Competition and Consumer Commission (**ACCC**) to provide advice on competitive tendering processes and pricing outcomes for several pipelines that are subject to legislative derogations under the Queensland Regime.[3]

As a result of its public processes, the Council identified a number of threshold certification issues. The Council liaised with the Queensland Government on these matters but was unable to reach agreement with Queensland on modifications to the regime that would address the issues.

The Council forwarded its recommendation on the effectiveness of the Queensland Regime to the Commonwealth Minister for Financial Services and Regulation in February 2001. Subsequently, the Minister notified the Council that he had received a substantial amount of new material from the Queensland Government and the owners of four gas pipelines subject to derogations under the regime. The Minister sought the Council's advice as to

1 Section 3 of this report provides an overview of the regime.

2 Reproduced in section 4.1 of this report.

3 The ACCC provided advice on the competitive tendering processes for pipelines 24, 30 and 41; and on pricing outcomes for pipelines 2, 24, 30 and 41. The pipelines are identified in full in Table 1, section 3.2 of this report. The legislative derogations are outlined in section 3.4 of this report.

whether this material raised new issues of relevance to his consideration of effectiveness.

To ensure that all relevant material was properly reflected in its advice to the Minister, the Council withdrew its February 2001 recommendation. The Council notified the Minister that it would forward a fresh recommendation once it had given full consideration to the submission from the Queensland Government and the joint submission from pipeline companies.

Given the length of time that elapsed since interested parties provided views on the effectiveness of the regime, the Council decided to release a draft recommendation on certification in February 2002, for comment from interested parties.

All parties that lodged submissions following release of the draft recommendation in February 2002 had previously lodged submissions with the Council. To a large extent, the further submissions received reiterated views expressed in earlier submissions. The Queensland Government and the owners of the pipelines the subject of this final determination, provided further details of the pipeline tender processes and the setting of pipeline reference tariffs to the Council on a confidential basis.

In September, the Council wrote to parties that had lodged further submissions asking for views as to whether the decision of the Supreme Court (WA) in *Re Ken Michael AM; Ex parte Epic Energy (WA) Nominees Pty Ltd & Anor* [2002] WASCA 231 (23 August 2002) ("Epic decision") had any implications for the Council's recommendation. The Council considered this to be appropriate given that the Court clarified the interpretation of a number of provisions of the National Gas Code. Some of those provisions are similar to the clause 6 principles, which the Council is required to apply in the context of this recommendation.

This final recommendation to the Minister takes into account the additional material provided as part of the further public consultation and submissions received on implications of the Supreme Court (WA) decision noted above. The use of material in this recommendation, which was provided to the Council on a confidential basis, was consented to by the relevant submitting party.

2 Final recommendation

The Council's final assessment of the Queensland Regime against the clause 6 principles takes account of public submissions received in both the first and second round of public consultations, discussions with interested parties, technical advice where relevant, new material forwarded to the Minister in 2001, as well as other relevant material that had not been available at the time the Council forwarded its original recommendation in February 2001.[4] In some instances, the Council has been obliged to draw on material that cannot be released publicly, due to confidentiality concerns. The Council identifies these instances in the body of the report.

The Queensland Regime is established under the *Gas Pipelines Access (Queensland) Act 1998* (**QGPAA**), which became operational in May 2000. The QGPAA applies the *Gas Pipelines Access Law (South Australia),* (**GPAL**) and in turn, the National Third Party Access Code for Natural Gas Pipeline Systems (**National Gas Code**).

Queensland sought certification of the regime as it applies to spare and developable capacity in natural gas pipelines that are covered under the National Gas Code. The Queensland Regime incorporates a number of coverage mechanisms, including mechanisms set out in the National Gas Code, and derogation arrangements in Queensland's access legislation.[5] The generic type of pipeline services subject to the National Gas Code are defined in s.10.8 of the Code.

Queensland sought certification of its access regime in relation to the services of natural gas transmission and distribution pipelines covered by the regime. This includes:

- pipelines specified in Schedule A of the GPAL as being under Queensland's jurisdiction (and are thus covered from the outset of the regime); and
- pipelines that subsequently become covered by the Queensland Regime.

Table 1 lists pipelines covered under the Queensland Regime as at January 2002.[6]

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4 The additional material includes public submissions to the ACCC's regulatory processes on access arrangements for pipelines covered by the Queensland Regime.

5 The coverage mechanisms are outlined in section 3.2 of this report.

6 Coverage of four pipelines originally listed at Schedule A of the National Gas Code, was terminated under the Code's revocation provisions in 2000. The relevant pipelines are: Kincora to Wallumbilla transmission pipeline; Dawson Valley to Duke

Table 1: Pipelines covered by Queensland Regime

Pipeline License (PPL) Number	Description of pipeline	Type of pipeline	Operator
2	Wallumbilla to Brisbane, commonly known as the **Roma to Brisbane Pipeline**, RBP.	transmission	Australian Pipeline Trust
24	Ballera to Wallumbilla, commonly known as the **South West Queensland Pipeline**, SWQP	transmission	Epic Energy
30	Wallumbilla to Rockhampton via Gladstone, commonly known as **the Queensland Gas Pipeline**, QGP.	transmission	Duke Energy
41	Ballera to Mt Isa, commonly known a the **Carpentaria Gas Pipeline**, CGP.	transmission	Australian Pipeline Trust
32	Gatton to Gympie pipeline[7]	transmission	pipeline not yet constructed
	Papua New Guinea to Queensland pipeline[8]	transmission	pipeline not yet constructed
	Allgas Energy/ENERGEX system (South Brisbane, Gold Coast, Toowoomba, Oakey)	distribution	Allgas Energy/ENERGEX
	Envestra/Origin Energy Asset Management system (North Brisbane, Ipswich, Gladstone, Rockhampton)	distribution	Envestra/Origin Energy Asset Management
	Roma system	distribution	Roma Town Council

On the basis of the information available to it, the Council has reached a final view that the Queensland Regime does not satisfy the clause 6 principles for the services of all covered pipelines in the State. As such, the Council's view is that the regime is not an effective access regime.

transmission pipeline system; Moura Mine to Duke transmission pipeline system; the Dalby distribution system.

7 Covered under a derogation in s.57 of the QGPAA. Queensland originally intended that this pipeline also be subject to derogated reference tariffs: s.58 of the QGPAA. However, derogated tariffs for this pipeline were never implemented.

8 Covered under a derogation at s.57 of the QGPAA.

In particular, the Council is not satisfied that the regime satisfies the clause 6 principles in relation to services of the following pipelines:

- Wallumbilla to Brisbane (license number 2, commonly known as the Roma to Brisbane Pipeline, RBP, or **pipeline 2**);
- Ballera to Wallumbilla (license number 24, commonly known as the South West Queensland pipeline, SWQP, or **pipeline 24**);
- Wallumbilla to Rockhampton via Gladstone (license number 30, commonly known as the Queensland Gas Pipeline, QGP, or **pipeline 30**); and
- Ballera to Mt Isa (license number 41, commonly known as the Carpentaria Pipeline, or **pipeline 41**).

Notwithstanding its position, the Council notes that its assessment has not raised substantive issues in relation to services provided by:

- existing natural gas distribution systems in Queensland;
- the proposed Papua New Guinea-Queensland gas pipeline; and
- transmission and distribution pipelines that become covered in the future by the Queensland Regime, under the coverage mechanisms in s.1 of the National Gas Code.

The Council's final assessment of the Queensland Regime against the clause 6 principles appears at section 4.2 of this report. The Council's final assessment has found that the regime raises substantial issues under clauses 6(4)(a)-(c), 6(4)(e), 6(4)(g) and 6(4)(i), and may also raise issues under clause 6(2).

3 The Queensland regime: an overview

3.1 Structure of the regime

The Queensland regime establishes a regulatory framework allowing parties to negotiate access to spare and developable capacity in natural gas transmission and distribution pipelines located in Queensland. The regime does not apply to foundation contracts or other pre-existing contractual arrangements.

Figure 1: Queensland transmission pipelines: Source Australian Gas Association

The regime applies a number of alternative access frameworks to different pipelines in the State. The central framework is the *National Third Party Access Code for Natural Gas Pipeline Systems* (**National Gas Code**), a National Competition Policy reform aimed at promoting free and fair trade in gas.

Since the signing of the *Natural Gas Pipelines Access Agreement* (**1997 Gas Agreement**), the National Gas Code has been progressively introduced by all Governments. As part of this framework, each jurisdiction has implemented its own state-based features of the Code.

The Queensland Regime is established under the *Gas Pipelines Access (Queensland) Act 1998* (**QGPAA**), which became operational in May 2000. The QGPAA:

- confers powers on relevant Code bodies, including the Commonwealth Minister and Commonwealth bodies such as the Australian Competition and Consumer Commission (**ACCC**), the Council and the Australian Competition Tribunal;
- establishes the Queensland Competition Authority (**QCA**) as regulator for gas distribution services;
- establishes the Queensland Gas Appeals Tribunal (**QGAT**) as the appeals body for determinations made by State bodies;
- establishes an access framework for cross-boundary pipelines; and
- establishes derogations affecting major transmission pipelines in Queensland.

The QGPAA also applies the *Gas Pipelines Access Law (South Australia),* **GPAL**, which covers cross-vesting arrangements for interstate pipelines, appeals provisions and sanctions and remedies for code breaches.

The GPAL, in turn, applies the National Gas Code, which sets out the rights and obligations of parties involved in the Queensland Regime. The Code addresses coverage rules, the operation and content of access undertakings, regulatory processes, ring fencing arrangements, information parameters, dispute resolution and pricing principles.

Three other elements of the Queensland Regime are:

- The *Gas Act 1965 (Queensland),* which sets out the contestability timetable for particular customers to be eligible to choose their gas supplier and enjoy a right to negotiate access to gas pipeline services in Queensland.
- The *Queensland Competition Authority Act 1997*, which establishes the QCA as the regulatory body for access to gas distribution services in the State.
- The *Gas Pipelines Access (Commonwealth) Act 1998*, which ensures, among other things, that the Queensland Regime applies to offshore waters and to the Moomba-Sydney pipeline. It also provides for the use of Commonwealth bodies in the operation of the National Code.

Viewing the Queensland Regime

- the QGPAA can be viewed at the website of the Office of the Queensland Parliamentary Counsel, at: www.legislation.qld.gov.au
- the National Gas Code can be viewed at the Code Registrar's website at: www.coderegistrar.sa.gov.au

3.2 Services covered by the regime

The Queensland Regime applies to spare and developable capacity in natural gas pipelines that are covered under the National Gas Code.

Services

The generic type of service that may be covered by the Queensland Regime is defined in s.10.8 of the National Gas Code as 'a service provided by means of a Covered Pipeline, including:

- haulage services (such as firm haulage, interruptible haulage, spot haulage and backhaul);
- the right to interconnect with the Covered Pipeline; and
- services ancillary to the provision of such services,
- but does not include the production, sale or purchasing of Natural Gas.'

'Pipeline' is defined in the GPAL to mean a pipe, or system of pipes, or part of a pipe, or system of pipes, for transporting natural gas, and any tanks, reservoirs, machinery or equipment directly attached to the pipe, or system of pipes, but does not include:

(i) unless paragraph (ii) applies, anything upstream of a prescribed exit flange on a pipeline conveying natural gas from a prescribed gas processing plant; or

(ii) if a connection point upstream of an exit flange on such a pipeline is prescribed (by regulation), anything upstream of that point; or

(iii) a gathering system operated as part of an upstream producing operation; or

(iv) any tanks, reservoirs, machinery or equipment used to remove or add components to or change natural gas (other than odourisation facilities) such as a gas processing plant; or

(v) anything downstream of the connection point (as defined by regulation) to a consumer.

Coverage mechanisms

Coverage of a pipeline under the Queensland Regime makes it subject to the obligations of the QGPAA and National Gas Code. The Code allows a pipeline to become covered in one of four ways:

1. Pipelines listed on Schedule A of the National Gas Code as being under Queensland's jurisdiction were automatically covered from when the Queensland Regime became operational in May 2000: s.1.1 of the Code.

2. Any person may apply to the Council for a pipeline to become covered under a case-by-case coverage mechanism in the National Gas Code. The Council must consider the matter through open and transparent processes, and make a recommendation to the relevant Minister[9], who makes a decision on the matter: ss.1.2-1.19 of the Code. The coverage criteria to be observed by the Council and Minister are set out at s.1.9 of the Code. These criteria closely reflect the coverage criteria for an effective access regime in clause 6(3) of the CPA.

   The s.1.9 coverage criteria require that:

   - access would promote competition in another market;
   - it would be uneconomic for anyone to develop another pipeline to provide the services of the pipeline in question;
   - access can be provided without undue risk to human health or safety; and
   - access would not be contrary to the public interest.

   The National Gas Code also allows parties to apply to the Council for revocation of coverage. On receipt of an application, the Council assesses whether the coverage criteria continue to apply to the relevant pipeline.

   The Queensland Regime provides for administrative review against Ministerial decisions on coverage and revocation of coverage (s.38 of the GPAL). The appeals bodies are the Australian Competition Tribunal (transmission pipelines) and the QGAT (distribution pipelines).

[9] Part 3 of the GPAL includes a 'closest connection' test to determine whether Queensland (or another jurisdiction) is the relevant jurisdiction for cross-border distribution pipelines.

3. The owner of a pipeline may propose an access arrangement to the relevant regulator. If the regulator approves the proposal, the pipeline becomes covered under the National Gas Code: s.1.20 of the Code.

4. A pipeline is automatically covered if it is subject to a competitive tendering process approved by the regulator under s.3 of the Code: s.1.21.

In addition to the coverage mechanisms in the National Gas Code, the Queensland Regime covers three pipelines through legislative derogations: s.57 of the QGPAA.[10] Queensland stated that the three pipelines were covered by way of derogation because they were not in existence at the time Schedule A of the National Gas Code (which only related to existing pipelines) was prepared. The purpose of the derogation was to ensure the yet to be constructed transmission pipelines were automatically covered by the National Gas Code upon its commencement (Queensland Treasury 2002).

Classification of covered pipelines

Schedule A of the National Gas Code classifies existing pipelines as transmission or distribution pipelines.

For pipelines not listed in Schedule A, the GPAL sets out a process whereby designated Ministers will decide whether a pipeline is to be classified as a transmission or distribution pipeline, following criteria set out in the Act. If the Ministers fail to reach agreement, they may request that the Council make a recommendation on the matter.

Scope of Queensland's certification application

Queensland seeks certification of its access regime in relation to the services of natural gas transmission and distribution pipelines covered by the regime. This includes:

- pipelines specified in Schedule A of the GPAL as being under Queensland's jurisdiction (and are thus covered from the outset of the regime); and

- pipelines that subsequently become covered by the Queensland Regime.

[10] Pipelines covered by s.57 of the QGPAA are: pipelines 32, 41 and the PNG-Queensland pipeline. See: Table 1.

Table 1 lists pipelines covered under the Queensland Regime as at January 2002.[11] Routes of existing transmission pipelines can be viewed on the map appearing at Figure 1 in section 3.1 of this report.

Table 1: Pipelines covered by Queensland Regime

Pipeline License (PPL) Number	Description of pipeline	Type of pipeline	Operator
2	Wallumbilla to Brisbane, commonly known as the **Roma to Brisbane Pipeline**, RBP.	transmission	Australian Pipeline Trust
24	Ballera to Wallumbilla, commonly known as the **South West Queensland Pipeline**, SWQP	transmission	Epic Energy
30	Wallumbilla to Rockhampton via Gladstone, commonly known as **the Queensland Gas Pipeline**, QGP.	transmission	Duke Energy
41	Ballera to Mt Isa, commonly known a the **Carpentaria Gas Pipeline**, CGP.	transmission	Australian Pipeline Trust
32	Gatton to Gympie pipeline[12]	transmission	pipeline not yet constructed
	Papua New Guinea to Queensland pipeline[13]	transmission	pipeline not yet constructed
	Allgas Energy/ENERGEX system (South Brisbane, Gold Coast, Toowoomba, Oakey)	distribution	Allgas Energy/ENERGEX
	Envestra/Origin Energy Asset Management system (North Brisbane, Ipswich, Gladstone, Rockhampton)	distribution	Envestra/Origin Energy Asset Management
	Roma system	distribution	Roma Town Council

[11] Coverage of four pipelines originally listed at Schedule A of the National Gas Code, was terminated under the Code's revocation provisions in 2000. The relevant pipelines are: Kincora to Wallumbilla transmission pipeline; Dawson Valley to Duke transmission pipeline system; Moura Mine to Duke transmission pipeline system; the Dalby distribution system.

[12] Covered under a derogation in s.57 of the QGPAA. Queensland originally intended that this pipeline also be subject to derogated reference tariffs: s.58 of the QGPAA. However, derogated tariffs for this pipeline were never implemented.

[13] Covered under a derogation at s.57 of the QGPAA.

3.3 How the regime operates

The Queensland Regime applies a number of alternative access frameworks to different pipelines in the State. The central framework is the National Gas Code, under which parties are free to negotiate access within an independent regulatory framework. Disputes may be referred to the regulator for arbitration.

A summary of the key features appears below. Certain features are modified or replaced for pipelines subject to derogations (see section 3.4 of this report).

Access arrangements

A central feature of the regulatory framework is a requirement that the owner/operator of a covered pipeline submit an *access arrangement* to an independent regulator within 90 days of a pipeline being covered. The regulator for transmission pipelines is the ACCC, while the QCA is the regulator for distribution pipelines.

An access arrangement must include:

- a services policy – a description of the services provided by the pipeline;
- reference tariffs for reference services (benchmark prices for services likely to be sought by a significant part of the market). The tariffs must comply with pricing principles set out in the National Gas Code;
- terms and conditions on which reference services will be provided;
- a trading policy – the rights of a pipeline user to trade their unused capacity;
- a queuing policy – rules for defining the priority that access seekers have in negotiating for capacity;
- an extensions/expansions policy – the approach used to determine whether an extension/expansion will treated as part of the pipeline for the purposes of the Code; and
- a review date – a date on which revisions to the access arrangement must be submitted to the regulator and a date on which the revised access arrangement will take effect.

The pipeline owner must also submit an *access arrangement information* package for approval. This document is intended to enable users and prospective users to understand the derivation of the elements of the

proposed access arrangement and must include the categories of information set out at Attachment A of the Code.

Regulatory approval process

The regulator must undertake a transparent public consultation process in deciding whether to approve a proposed access arrangement and access arrangement information. In doing so, the regulator must take into account a range of factors set out in s.2.24 of the Code, which closely reflects clause 6(4)(i) of the CPA. The regulator is equipped with discretions and enforcement powers, including powers to obtain information and documents necessary to perform these tasks.

If the regulator does not approve a proposed access arrangement, the service provider must amend it and then resubmit it. The regulator may impose an access arrangement if the service provider fails to submit an access agreement or if required revisions are not made within a specified time.

The regulator must issue a final decision on an access arrangement within six months of receiving the proposed arrangement. However, regulators do have the option to increase this period by two-month intervals provided notice of the extension is published in a national newspaper.

If an access arrangement is approved for longer than five years, the regulator must consider the inclusion of revenue sharing mechanisms to address the risk of demand and profit forecasts proving too conservative.

The up-front approval of access arrangements by an independent regulator is designed to provide some certainty to the parties: a facility owner is obliged to honour the terms and conditions set out in an access agreement, including the reference tariffs; and the tariffs cannot be varied in arbitration (though they can be varied through negotiation). In providing independent price guidance, the framework also helps address imbalances in negotiating power between facility owners and access seekers. In doing so, it provides a platform for third parties to enter access negotiations, and may reduce the need for time-consuming and costly disputes.

While reference tariffs are typically set through regulatory approval of an access arrangement, an alternative for new pipelines is for reference tariffs to be determined through a competitive tendering process: ss.3.21-3.36 of the National Gas Code. The tendering process is subject to independent regulatory oversight, with outcomes vetted to ensure compliance with the approved process.

Reference tariff principles

S.8 of the National Gas Code sets out reference tariff principles (applicable to tariffs set through regulatory assessment or competitive tendering). The

general principles in s.8 provide that a reference tariff should be designed with a view to:

- allowing the service provider the opportunity to earn a stream of revenue that recovers the efficient costs of delivering the reference service over the expected life of relevant assets;
- replicating the outcome of a competitive market;
- ensuring the safe and reliable operation of the pipeline;
- not distorting investment decisions in gas pipelines or in upstream and downstream industries;
- efficiency in level and structure; and
- providing incentives to reduce costs and develop the market for pipeline services.

Negotiation around regulated outcomes

Once an access arrangement is approved, a service provider is required to respond to a request for access within a reasonable timeframe and must use all reasonable endeavours to accommodate the requirements of access seekers.

Third parties are entitled to gain access to reference services on the terms and conditions set out in the access arrangement. However, parties are free to negotiate around the reference tariffs, with access seekers able to draw on information in the access arrangement and access arrangement information package.

In particular, parties are free to negotiate tariffs for reference services that vary from the reference tariffs. Moreover, parties are free to negotiate prices for non-reference services, with reference tariffs providing some guidance in this regard.

Dispute resolution

If commercial negotiations fail to resolve access issues, a dispute can be referred to the regulator, who may then arbitrate and set the terms and conditions of access.

In making a decision, the arbitrator must apply the provisions of the access arrangement (including the reference tariffs) and take account of a range of matters that closely reflect clause 6(4)(i) of the CPA.

Appeal Rights

Decisions of the regulator are subject to judicial review. For decisions by the ACCC, judicial review is carried out by the Federal Court under the *Administrative Decisions (Judicial Review) Act 1977 (Commonwealth):* ss.20-21 of the QGPAA. Decisions of the QCA are appealable to the Supreme Court of Queensland under the *Queensland Judicial Review Act 1991.*

The National Gas Code provides that merit-based administrative review is allowed for certain decisions of the Minister and regulator with regard to: coverage, ring fencing, regulator imposed access arrangements, approval of affiliate contracts and decisions covering information disclosure.

The relevant appeals bodies are noted in Table 2.

Table 2 Appeals bodies: Queensland Regime

Decision making body	Judicial Review body	Administrative appeal body
ACCC	Federal Court	Australian Competition Tribunal
Queensland Competition Authority	Queensland Supreme Court	Queensland Gas Appeals Tribunal
Queensland Minister	Queensland Supreme Court	Queensland Gas Appeals Tribunal
Commonwealth Minister	Federal Court	Australian Competition Tribunal

Enforcement of Decisions

The GPAL provides for enforcement of obligations under the Queensland Regime. Under Part 5, a range of sanctions and remedies (including injunctions and damages) are available, depending on the provision breached. Sanctions and remedies are imposed by the Federal Court or the Supreme Court of Queensland.

3.4 Derogations & transitional arrangements

The operation of the Queensland Regime, as outlined in section 3.3 of this report, is modified for pipelines subject to legislative derogations. The principal derogations relate to:

- regulatory processes for setting reference tariffs and related matters for major transmission pipelines: s.58 of the QGPAA.
- access principles for the Papua New Guinea – Queensland gas pipeline: s.59 of the QGPAA.

The operation of the National Gas Code is also modified by transitional arrangements to phase in consumer contestability: ss.5B and 5C of the *Gas Act 1965*.

3.4.1 Regulatory processes for s.58 pipelines

S.58 of the QGPAA establishes derogations that quarantine four major transmission pipelines (“**s.58 pipelines**”) from having to comply with tariff-setting aspects of the National Gas Code, including:

- regulatory processes for setting reference tariffs;
- reference tariff principles;
- regulatory review arrangements; and
- provision of information to third parties on the derivation of reference tariffs.

Instead, alternative regulatory arrangements apply. In particular:

- “derogated” reference tariffs and related matters are approved by the Queensland Minister for Mines and Energy. The Council understands that the derogated tariffs are pre-existing tariffs originally approved by the Queensland Minister prior to implementation of the National Gas Code. The original approvals occurred between 1995 and 1997 under Part 8 of the *Petroleum Act 1923;* and
- the owners of some pipelines are not required to provide information to access seekers on the derivation of reference tariffs.

The Minister-approved tariffs will remain in force for periods of up to 25 years, depending on the review date for the access arrangement of each pipeline.

Table 3 lists the s.58 pipelines and the duration of each derogation arrangement. Once a derogation expires, the pipeline will become subject to the regulatory framework of the National Gas Code.

The routes of these pipelines can be viewed at Figure 1 (section 3.1 of this report). Background information on the pipelines is provided in Box 1.

Table 3 Queensland pipelines subject to s.58 derogations[14]

Pipeline License Number	**Description of pipeline**	**Derogation terminates**
2	Wallumbilla to Brisbane, commonly known as the Roma to Brisbane pipeline **RBP**	29 July 2006
24	Ballera to Wallumbilla, commonly known as the South West Queensland Pipeline, **SWQP**	30 December 2016[15]
30	Wallumbilla to Gladstone via Rockhampton, commonly known as the Queensland Gas Pipeline, **QGP**	31 August 2016
41	Ballera to Mt Isa, commonly known as the Carpentaria Gas Pipeline, **CGP**	1 May 2023

Queensland's certification application provides the following explanation of the reasons for the derogations:

> *These arrangements were set by the then Queensland regulator prior to the finalisation of the Code and, apart from the Roma to Brisbane pipeline, were the basis upon which private sector investors:*
>
> - *entered into agreements with the Queensland Government to construct two important new pipelines in South West Queensland; and*
>
> - *in the case of the Wallumbilla to Rockhampton pipeline, invested in an existing pipeline which serves a developing gas market.*
>
> *In recognition of the risks involved in these investments, the Queensland Government sought to preserve the arrangements by way of a transitional [grandfathering] measure in the form of the derogations (Qld Govt 1998).*

The Council understands that apart from reference tariff and tariff-related matters, the National Gas Code applies fully to the s.58 pipelines, with the ACCC as regulator. For example, National Code requirements such as ring

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[14] In addition to the pipelines listed in Table 3, s.58 provides for derogated arrangements for a fifth pipeline: the proposed Gatton to Gympie pipeline (license No. 32). Queensland informs the Council that the Minister did not gazette derogated tariff arrangements for pipeline 32 within 30 days of the commencement of s.58. Consequently, tariffs for the pipeline are not derogated. The pipeline, if constructed, will be fully subject to the provisions of the National Gas Code.

[15] For AFT services (alternative form of transportation service to a full forward reference service), the review date is 11 June 2004.

fencing arrangements, regulatory approval of access arrangements, and dispute resolution procedures, are not varied by the derogations.

The Queensland Government states, with regard to s.58 pipelines, that:

> *…access principles…approved under the* Petroleum Act*… will form the basis of the access arrangements under the Code and will be administered by the Australian Competition and Consumer Commission ("ACCC"). The access arrangements are to set out all of the terms and conditions upon which users and prospective users may gain access to the reference services offered by the pipeline. Those matters contained in the access arrangements that are not preserved under the derogations are subject to the normal Code processes and procedures (Qld Govt 2000a, p.4).*

Box 1 **Section 58 pipelines: background**

Pipeline 2 Roma to Brisbane pipeline (RBP)

The Wallumbilla to Brisbane Pipeline, commonly referred to as the Roma to Brisbane Pipeline ('RBP'), was commissioned in 1967, with AGL acquiring an 85% interest from CSR in 1988. Australian Pipeline Trust Petroleum Pipelines Ltd (APT) now owns and operates the RBP.

The RBP, completed in 1969, was constructed to meet the energy needs of the utility distribution systems and major industrial and power generation facilities in southeastern Queensland and the Brisbane metropolitan area. The original RBP is a 250 mm diameter pipeline designed to receive gas from the gas hub at Wallumbilla, near Roma, in south central Queensland. In addition, gas is supplied from the South-west Queensland Producers via a pipeline from Ballera. Gas is transported to markets in southern-central Queensland and into Brisbane and south-east Queensland.

The capacity of the pipeline was increased by compression between 1981 and 1986 and continues to be expanded through looping that commenced in 1998.

Pipeline 24 South West Queensland Pipeline (SWQP)

The Ballera to Wallumbilla pipeline, commonly known as the South-West Queensland Pipeline (SWQP) was constructed in 1996 by Tenneco Gas Australia and is now operated by Epic Energy (Queensland) Pty Ltd.

This pipeline transports gas from the Cooper Basin in south-west Queensland, to Wallumbilla, where it interconnects with the RBP. The pipeline is 756 km long, with a diameter of 406mm and operating pressure of 15Mpa.

Pipeline 30 Queensland Gas Pipeline (QGP)

The 627km Wallumbilla to Gladstone Pipeline, commonly known as the Queensland Gas Pipeline (QGP), supplies gas from several sources, including the Dennison Trough of the Surat Basin near Westgrove; coal seam methane near Rolleston and Moura; and from the south west Queensland fields via the SWQP.

Inlet stations are located at Wallumbilla, Westgrove, Rolleston and Moura. Outlet stations are at Larcom Creek, the Gladstone and Rockhampton City gates, and QAL in Gladstone.

The Queensland Government commissioned the QGP in December 1989, with an extension to Rockhampton included in 1991. The QGP was sold to Pacific Gas Transmission (PGT) Australia Pty Limited in July 1996. Duke Energy purchased the pipeline from PGT in 1998. Duke Energy International Queensland Gas Pipeline Pty Ltd and Duke Queensland Pipeline Pty Ltd now own the QGP. Duke Australia Pty Ltd operates the pipeline as the agent for the owners.

Pipeline 41 Carpentaria Gas Pipeline (CGP)

The Carpentaria Gas Pipeline (CGP) transports gas from the fields at Ballera in south west Queensland to Mount Isa in north west Queensland. It was constructed to meet the energy needs of the mining industry in north west Queensland and carries gas to mines and power generation facilities. Construction of the CGP commenced in 1997 following a bidding process and was completed in 1998. AGL was successful in obtaining the development rights for the pipeline through Roverton Pty Ltd, at that time a subsidiary of AGL. The asset comprises 840 km of transmission pipeline along with associated facilities and infrastructure. Associated with CGP are the Cannington lateral, the Mount Isa Lateral and the Mica Creek metering facility.

On 13 June 2000, AGL floated its gas pipeline assets through the Australian Pipeline Trust, which owns 70 per cent of the CGP and 100 per cent of the lateral to Cannington. The other parties to the joint venture are the South-West Queensland gas producers (comprising Santos Ltd; Delhi Pty Ltd; Boral Energy Resources Ltd; Vamgas Pty Ltd; Australian Hydrocarbons Ltd; and Oil Company of Australia).

3.4.2 Access principles for PNG-Queensland Pipeline

S.59 of the QGPAA derogates, for a period, the access principles to apply to the proposed Papua New Guinea (PNG)-Queensland gas pipeline. Access principles for the pipeline are being developed through a competitive tendering process, which commenced prior to the National Gas Code being implemented in Queensland. The access principles have been progressed under the *Queensland Petroleum Act 1923.*

The Council understands that measures were taken to ensure that the tendering process for the PNG-Queensland Pipeline is as consistent as possible with the National Gas Code. In particular, s.59 of the QGPAA requires that access principles for the pipeline be agreed to by the ACCC, which will then advise the Queensland Minister as to whether the principles are appropriate.

The Council understands that the derogated access principles will apply for 20 years from the date of the first commercial gas deliveries through the pipeline. Subsequently, access principles will be subject to the National Gas Code.

3.4.3 Contestability arrangements

The Council notes that the Queensland Government does not consider that the Queensland Regime includes a contestability timetable that phases in customer eligibility to choose their gas supplier. This differs from the Council's position that contestability timetables are an important part of jurisdictions' gas access arrangements. This is because to be effective, an access regime must adequately provide for access to all customers and not just to a distinct group of large customers.

Queensland's contestability timetable differs from that originally outlined in its implementation legislation, with significant delays for all customers. Queensland informs the Council that the delays have been caused by implementation issues that need to be addressed to ensure fair and effective competition

The initial and revised contestability timetables are as follows:

Table 4 Queensland Contestability Arrangements

	Initial	Revised
1 January 2000	≥ 100 terajoules per annum	
1 July 2001		≥ 100 terajoules per annum
1 September 2001	All customers	
1 January 2003		All customers

4 Statement of Reasons

4.1 Background

S.44M of the TPA provides for the Council to recommend to the Commonwealth Minister on the effectiveness of an access regime established by a State or Territory government. The Council must recommend that the regime is either effective or not effective. If the Council recommends certification, it must also recommend the period for which the Minister's decision should be in force.

In making its recommendation, the Council must consider the relevant principles set out in clauses 6(2) to 6(4)(p) of the *Competition Principles Agreement* (**clause 6 principles**, see below), and must not consider any other matters: s.44M(4) of the TPA. In doing so, the Council must treat each principle as having the status of a guideline rather than a binding rule: s.44DA(1). Further, an access regime may contain additional matters that are not inconsistent with the clause 6 principles: s.44DA(2).

In its application, Queensland noted that the Queensland Regime represents an enactment of the National Gas Code with a number of state-based elements appended. The Council has previously considered the effectiveness of the National Gas Code in two contexts. First, the Council undertook an extensive public consultation process in its assessment of the National Code in September 1997, and found that the broad operation of the Code satisfies the clause 6 principles.

Subsequently, the Council considered a number of aspects of the National Gas Code in the context of its recommendation on the South Australian Gas Pipelines Access Regime – the first application of the National Gas Code to be assessed by the Council. The Council recommended that the South Australian Regime satisfied the clause 6 principles, and the regime was certified as effective by the Commonwealth Minister for Financial Services and Regulation in December 1998. The effectiveness of the National Gas Code has since been reaffirmed through Ministerial decisions to certify applications of the Code in New South Wales, Victoria, Western Australia, the ACT and the Northern Territory.

Given that the Council has previously considered many aspects of the Queensland Regime in the context of its assessments of the National Gas Code, the Council draws, where relevant, on its earlier work in the current assessment. Those matters not previously assessed by the Council are state-specific features of the National Gas Code as it applies in Queensland. As such, these features are the principal focus of the current report.

The clause 6 principles

6(2) The regime to be established by Commonwealth legislation is not intended to cover a service provided by means of a facility where the State or Territory Party in whose jurisdiction the facility is situated has in place an access regime which covers the facility and conforms to the principles set out in this clause unless:

(a) the Council determines that the regime is ineffective having regard to the influence of the facility beyond the jurisdictional boundary of the State or Territory; or

(b) substantial difficulties arise from the facility being situated in more than one jurisdiction.

6(3) For a State or Territory access regime to conform to the principles set out in this clause, it should:

(a) apply to services provided by means of significant infrastructure facilities where:

(i) it would not be economically feasible to duplicate the facility;

(ii) access to the service is necessary in order to permit effective competition in a downstream or upstream market; and

(iii) the safe use of the facility by the person seeking access can be ensured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist; and

(b) incorporate the principles referred to in subclause (4).

6(4) A State or Territory access regime should incorporate the following principles:

(a) Wherever possible third party access to a service provided by means of a facility should be on the basis of terms and conditions agreed between the owner of the facility and the person seeking access.

(b) Where such agreement cannot be reached, governments should establish a right for persons to negotiate access to a service provided by means of a facility.

(c) Any right to negotiate access should provide for an enforcement process.

(d) Any right to negotiate access should include a date after which the right would lapse unless reviewed and subsequently extended; however, existing contractual rights and obligations should not be automatically revoked.

(e) The owner of a facility that is used to provide a service should use all reasonable endeavours to accommodate the requirements of persons seeking access.

(f) Access to a service for persons seeking access need not be on exactly the same terms and conditions.

(g) Where the owner and a person seeking access cannot agree on terms and conditions for access to the service, they should be required to appoint and fund an independent body to resolve the dispute, if they have not already done so.

(h) The decisions of the dispute resolution body should bind the parties; however, rights of appeal under existing legislative provisions should be preserved.

(i) In deciding on the terms and conditions for access, the dispute resolution body should take into account:

(i) the owner's legitimate business interests and investment in the facility;

(ii) the costs to the owner of providing access, including any costs of extending the facility but not costs associated with losses arising from increased competition in upstream or downstream markets;

(iii) the economic value to the owner of any additional investment that the person seeking access or the owner has agreed to undertake;

(iv) the interests of all persons holding contracts for use of the facility;

(v) firm and binding contractual obligations of the owner or other persons (or both) already using the facility;

(vi) the operational and technical requirements necessary for the safe and reliable operation of the facility;

(vii) the economically efficient operation of the facility; and

(viii) the benefit to the public from having competitive markets.

(j) The owner may be required to extend, or to permit extension of, the facility that is used to provide a service if necessary but this would be subject to:

(i) such extension being technically and economically feasible and consistent with the safe and reliable operation of the facility;

(ii) the owner's legitimate business interests in the facility being protected; and

(iii) the terms of access for the third party taking into account the costs borne by the parties for the extension and the economic benefits to the parties resulting from the extension.

(k) If there has been a material change in circumstances, the parties should be able to apply for a revocation or modification of the access arrangement which was made at the conclusion of the dispute resolution process.

(l) The dispute resolution body should only impede the existing right of a person to use a facility where the dispute resolution body has considered whether there is a case for compensation of that person and, if appropriate, determined such compensation.

(m) The owner or user of a service shall not engage in conduct for the purpose of hindering access to that service by another person.

(n) Separate accounting arrangements should be required for the elements of a business which are covered by the access regime.

(o) The dispute resolution body, or relevant authority where provided for under specific legislation, should have access to financial statements and other accounting information pertaining to a service.

(p) Where more than one State or Territory regime applies to a service, those regimes should be consistent and, by means of vested jurisdiction or other co-operative legislative scheme, provide for a single process for persons to seek access to the service, a single body to resolve disputes about any aspect of access and a single forum for enforcement of access arrangements.

4.2 Assessment against clause 6

4.2.1 S.58 arrangements: policy issues & historical contexts

In considering the effectiveness of an access regime, the Council must apply the clause 6 principles, and not consider any other matters: s.44M(4) of TPA.

The Queensland Government and the current owners of s.58 pipelines (APT, Duke and Epic) have argued that a number of policy issues and historical contexts are relevant to the certification process. According to the owners:

> *It is critical to understand the circumstances that led to the inclusion of the derogations in both the Intergovernmental Agreement and the Queensland Regime as the test under section 44N of the TPA can only properly be applied in light of these circumstances (Duke, Epic, APT 2001, p.4)*

The Council notes that the following have been raised as relevant considerations:

- s.58 was intended as a transitional measure to phase in the National Gas Code;
- the s.58 arrangements are recognised in the 1997 *Natural Gas Pipelines Access Agreement;*
- the s.58 arrangements are justified on public policy grounds including: the need to address sovereign risk and to promote investment and economic development;
- failure to certify the Queensland Regime could lead to the reopening of pre-existing contracts; and
- applying the National Gas Code to s.58 pipelines would impose significant compliance costs.

The Council examines each of these considerations below.

S.58 as a transitional arrangement

An argument raised by Queensland is that the s.58 arrangements should be viewed as a transitional phase-in of the National Gas Code, which has been certified by the Minister as an effective access regime:

> *...the review periods for the pipelines are ... justifiable arrangements in the context of facilitating infrastructure investment and the development of a gas market. This concept was acknowledged by the Council of Australian Governments (COAG) in 1994 when it endorsed a report that stated that arrangements of longer duration were "essential to the development of the gas market, to enable the sharing of the risks of the very large investments required...". For this reason, COAG decided to protect pre-existing contracts and to allow a transition to the new regime. It is strongly urged that the pre-existing arrangements be considered in this light (Qld Govt 2001, p.7).*

Owners of the s.58 pipelines (Duke Energy, Epic Energy and APT) make a similar point:

> *...the derogations were agreed to by all COAG signatories to the Natural Gas Pipelines Access Agreement (1997) as being transitional in nature. It was considered that it was in the public interest that these transitional provisions be included, as the pipelines to which the derogations apply will eventually be covered by all aspects of the National Code (Duke, Epic, APT 2001, p.3).*

In considering this argument, the Council notes that it has previously recommended certification of access regimes that phase in competition arrangements for different customer groups. The duration of these phase-in arrangements has typically ranged from several months to two or three years. The Council has found that while transitional arrangements constrain the rights of some parties to negotiate access in the short term, they can also help parties to adjust from a sheltered market environment to a more competitive one. As such, appropriate transitional arrangements can sometimes improve the negotiation framework. Nonetheless, the Council has consistently held that transitional arrangements should be phased out as early as possible.

The Council observes that the s.58 arrangements have a duration of up to 25 years. The Council does not consider such a long duration as appropriate to address transitional phase-in issues.

The Council has also distinguished between transitional arrangements that phase in contestability across different customer classes, and derogations that preclude all customers from using an access regime in relation to particular services. The Council notes, for example, that Western Australia sought certification in March 1999 of its implementation of the National Gas Code (**WA Regime**). However, application of the regime to major transmission pipelines was delayed until January 2000, with a transitional regime in place for the interim period. The Council considered it inappropriate to recommend certification of the WA Regime while alternative arrangements applied to major transmission pipelines (NCC 2000a).

The Council notes that s.58 alters the rights of *all* customers to seek access to the affected pipelines under the National Gas Code. While some aspects of these arrangements reflect the National Gas Code, other aspects (such as

access pricing) are quite different. In this regard, the Council notes the joint submission of the owners of the pipeline that:

> *The provisions of the National Gas Code outlining a parties' right to negotiate access and the dispute resolution mechanisms are in no way restricted by the inclusion of derogations. The derogations simply set a different mechanism for the determination of reference tariffs …" (Duke, Epic, APT 2002, p.10).*

While the Council notes that use of derogations as transitional measures was contemplated by the Inter-Governmental Agreement, it is unable to view s.58 as a transitional phase-in of the National Gas Code, but as having the effect of substituting an alternative access framework. Given the critical nature of the reference tariffs to the overall access arrangements, a derogation of up to 25 years in respect of the tariffs suggests that the arrangements amount to an alternate access framework rather than being transitional arrangements. On this basis, the Council considers that the Queensland Regime must be assessed, in its own right, against the clause 6 principles.

1997 Gas Agreement

The Queensland Government and s.58 pipeline owners argue that the s.58 arrangements are appropriate because they were approved by all Australian Governments in the 1997 *Natural Gas Pipelines Access Agreement* (**1997 Gas Agreement**) as derogations from the National Gas Code.

In a joint submission, owners of the s.58 pipelines argue that:

> *The derogations for the pipelines are necessary transitional measures.... This is confirmed by virtue of clause 12 of the Intergovernmental Agreement which includes recognition by all jurisdictions that the derogations:*
>
> - *are limited to those essential to the orderly introduction of the arrangements contemplated by the National Code; and*
> - *do not prevent the existence of a competitive natural gas market characterised by access to all gas consumers and all gas producers in the State (Duke, Epic, APT 2001, p.6).*

The submission argues that all issues arising from the derogations should have been addressed in the context of the intergovernmental agreement process:

> *… the consultative process that led to the signing of the Intergovernmental Agreement enabled proper concerns about the derogations to be raised and dealt with in the Agreement itself. Furthermore, the gas pipeline industry participated in the development of the Intergovernmental Agreement in good faith and its support... was based on the understanding that the existing access*

principles for the derogated pipelines would be maintained (Duke, Epic, APT 2001, p.6).

The joint submission points out that Queensland insisted on the derogations as a pre-condition for the State participating in national gas reform. The submission argues that the signatories did not intend that the arrangements could be unwound, and that to do so could undermine the credibility of all future intergovernmental processes.

It is quite clear from the Intergovernmental Agreement that the signatories to that agreement did not intend that the derogations could be unwound, especially derogations which were Queensland's condition of entry. Not only does a decision to not certify the regime as effective give rise to sovereign risk issues for the pipeline owners, it also questions the credibility of future intergovernmental agreements (Duke, Epic, APT 2001, p.14).

The Council notes that under clause 12.1 of the 1997 Gas Agreement, consideration of the effectiveness of an access regime should not be constrained by the Agreement's provisions on transitional arrangements and derogations. Clause 12.1 states, in part:

The Parties note that the specification of transitional arrangements and derogations in Annex H, Annex I and the Access Legislation of a particular jurisdiction, or the decision of Ministers under clauses 5.3 or 12.1, does not limit the discretion of the Commonwealth Minister to certify or not certify the access regime embodied in a jurisdiction's Access Legislation (including the Code) as an effective access regime under section 44N of the Trade Practices Act or the National Competition Council's discretion under section 44M of the Trade Practices Act.

The wording of clause 12.1 indicates that while the s.58 derogations were approved by Australian Governments, it was never intended that this approval would act as an exemption from Part IIIA of the TPA. Part IIIA requires the Council (and the Minister) to assess the negotiation, regulatory and dispute resolution framework of an access regime against a set of guiding principles laid out in clause 6 of the CPA. The Council must assess an access regime on merit against these principles, as envisaged by the 1997 Gas Agreement.

Sovereign risk, investment and economic development issues

Owners of the s.58 pipelines argue that preservation of the derogations is essential to avoid serious sovereign risk issues:

... a decision that the Queensland Regime is not effective would pose serious sovereign risks, not only to state governments but also private developers of pipelines in Australia. It would also create significant financial risks for companies which invested significant funds on the

basis of access principles approved under an existing access regime which was believed to comply with the CPA principles. Furthermore, the companies made these financial commitments on an understanding that the introduction of a national gas access framework would not lead to a re-opening of existing arrangements. The consequences would be contrary to one of the original intentions of competition reform - to further economic and regional development, including employment and investment growth (Duke, Epic, APT 2001, p.3).

The pipeline owners further note that:

It was in the public interest to ensure that the basis of the investment decisions by the pipeline owners was incorporated into the transitional provisions of the national gas access framework so as to ensure that the establishment of the national access framework did not undo previous regulatory decisions in respect of the pipelines, both to recognise the reliance placed on those regulatory decisions and also to ensure that introduction of the regime did not create sovereign risk (Duke, Epic, APT 2001, p.5).

The Queensland Government supports this view, stating that the s.58 arrangements are needed to protect the pre-existing commercial interests of pipeline owners:

These derogations are required to protect existing pipeline access principles (tariffs in particular) in Queensland as they were negotiated prior to the development of the Gas Pipelines Access Law. As pipeline licensees were unable to know the contents of the then proposed Gas Pipelines Access Law when negotiating their access principles, the retrospective application of the Law could jeopardise the commercial position of pipeline licensees (Qld Govt 1998).

The Queensland Government also argues that the arrangements are justified on wider public policy grounds:

The tariff outcomes and the revision periods for each of the pipelines reflect the composition and development of the gas market in Queensland at the time of their approval. The history of the development of the gas market should be recognised when considering the tariff outcomes and revision periods established for the derogated pipelines. In particular, Queensland's gas pipeline infrastructure has largely been constructed by the private sector in market circumstances which have, in the main, been characterised by a high degree of risk. In the main, the pipelines in question have been developed on a "greenfields" basis with a view to enhancing the economic prospects of Queensland communities by facilitating future industrial and mining ventures.

Many of Queensland's gas markets are in the development phase and are unlike the larger, more mature southern gas markets in Victoria or

> *New South Wales. The risks associated with these pipeline investments were, and are, not insubstantial and the Queensland Government was not able to commit public funds to underwrite these risks. It was, and is important to encourage private sector participation in the construction and operation of major pipeline infrastructure. There must be a reasonable reward for undertaking these risks and a means to provide some security for the investors undertaking these projects, especially in the environment of embryonic markets (Qld Govt. 2000b, p.2).*

In a submission to the Minister, Queensland reiterated its view that the use of access regulation to promote economic development was appropriate:

> *The regime should... not be penalised on the basis of an argument that a Minister may wish to facilitate economic development by way of creating the conditions/incentive for investment in infrastructure which has a net public benefit (Qld Govt. 2001, p.11).*

Queensland argues that its approach is consistent with a draft review of Part IIIA by the Productivity Commission (**PC**):

> *The Productivity Commission has recently raised the issue of the costs to society of investment not proceeding as a result of regulatory constraints and has recommended an approach to access regulation which seeks to place greater emphasis on the objective of promoting investment in essential infrastructure services (Qld Govt. 2001, p.11).*

The Council notes the views of Queensland (and the affected pipeline companies) that access tariffs for s.58 pipelines were set with an aim of promoting the environment for investment and economic development, and that their preservation is essential to avoid sovereign risk issues. The Council considers that the environment for investment and economic development are relevant considerations to an assessment of the Queensland Regime against clause 6. In particular, clause 6(4)(i) states that in determining the terms and conditions of access, the dispute resolution body[16] should take account of a range of specified factors, including the owner's legitimate business interests and investment in a facility. But while the environment for investment and appropriate returns to investors are relevant to price setting in an effective access regime, the Council observes that these objectives need to be balanced against several other considerations. In particular, clause 6(4)(i) lists the following considerations, which are relevant factors in price setting:

- the costs to the owner of providing access, including costs of extending a facility, but not costs associated with losses arising from increased competition in upstream or downstream markets: 6(4)(i)(ii). The Council

[16] Where an access regime constrains the terms and conditions of access that the dispute resolution body can determine, the Council considers that an effective access regime should include consideration of clause 6(4)(i) matters as part of the regulatory process.

considers that this provision may point towards efficient cost-related pricing, with a view towards reducing or removing monopoly rents;

- the economically efficient operation of the facility: 6(4)(i)(vii). The Council considers that this provision points towards efficient access prices that encourage efficient usage of infrastructure, rather than monopoly pricing that may constrain demand; and
- the benefit to the public from having competitive markets: 6(4)(i)(viii). The Council considers that this provision suggests that the public interest is likely to be best served through cost-reflective access prices that promote competition in other markets.

Clauses 6(4)(i): (vii), (viii) and possibly (ii) in particular point strongly towards efficient, cost-reflective pricing that promotes efficient resource allocation and competitive markets. The Council notes, however, that these objectives need to be balanced against the remaining clause 6(4)(i) principles, including the legitimate business interests of the access provider and the interests of other parties. In this sense, the Council considers that clause 6(4)(i) points towards access tariffs that achieve an appropriate balance between a range of (sometimes conflicting) interests, including the interests of investors, consumers, access seekers, and existing contract holders.

The Council notes the view of the pipeline owners that:

> *The derogations recognise the pipeliners' business interests and preserve their expectations under the prior regulatory regime. In light of the DBNGP Decision*[17] *the inclusion of these matters in the Queensland regime is therefore not inconsistent with section 6.4 (Sept 2002).*

The Council agrees that the interests of pipeline owners is a relevant consideration as expressly provided for in clause 6(4)(i). This consideration, however, needs to be balanced against the other express considerations set out in the clause.

The Council further notes the view of the Queensland Government and major pipeline companies that it should adopt a flexible approach to clause 6, given that s.44DA(1) states that each principle is a "guideline" rather than "a binding rule." In addition, the parties point out that s.44DA(2) provides that an effective regime may contain additional matters that are not inconsistent with clause 6 (Qld Govt 2000a, p.1; Duke, Epic APT 2001, p.7).

The Council is cognisant of the discretion vested in the Council and the Minister under s.44DA(1). The discretion relates to the interpretation of "each individual relevant principle." The Council considers that this discretion does

[17] The Supreme Court (WA) decision in *Re Ken Michael AM; Ex parte Epic Energy (WA) Nominees Pty Ltd & Anor* [2002] WASCA 231 (23 August 2002).

not extend to allowing the Council or the Minister to choose assessment criteria other than the clause 6 principles.

The Council is also cognisant of the provision allowing an access regime to contain additional matters that are not inconsistent with clause 6. With this in mind, the Council considers that any additional matters in a regime have no bearing on its effectiveness, unless these matters are inconsistent with clause 6.

Effects on pre-existing contracts

Owners of the s.58 pipelines argue that certification of the Queensland Regime is necessary not only to preserve pre-existing access principles, but also to preserve pre-existing access contracts.

> *... a failure to certify the Queensland Regime as effective has the potential to directly affect all foundation contracts and other pre-existing contracts for services on the pipelines. If the Commonwealth Minister decides that the Queensland Regime is not effective, any person (including current users of the pipelines) can seek a declaration of a service relating to the pipelines under Part IIIA of the TPA. If the service is declared, that person becomes entitled to negotiate the terms of access and, if agreement cannot be reached, is entitled to seek arbitration by the ACCC. As the ACCC has power as arbitrator to effectively set aside existing contracts, a current user of the pipelines could use the declaration and arbitration process as a mechanism to revisit a foundation contract which was voluntarily entered into. There is no suggestion that this is an intended outcome of the CPA, the Intergovernmental Agreement and the introduction of the National Code (Duke, Epic, APT 2001, p.13).*

A number of participants dispute the logic of these claims. According to Envestra:

> *...there is already a mechanism in the Code that recognises pre-existing contracts. Derogations of this nature are not necessary to protect the commercial interests of pipeline owners holding such contracts (Envestra submission 1999).*

In considering this argument, the Council notes that it is appropriate for an effective access regime to preserve pre-existing access contracts. In particular, clause 6(4)(i) notes that in deciding the terms and conditions of access, it is relevant to take account of:

- the interests of all persons holding contracts for use of the facility: 6(4)(i)(iv); and
- firm and binding contractual obligations of the owner or other persons (or both) already using the facility: 6(4)(i)(v).

But clause 6(4)(i) lists these among many relevant considerations. For example, 6(4)(i) lists, as other relevant factors in price setting:

- the owner's legitimate business interests and investment in the facility: 6(4)(i)(i);
- the costs to the owner of providing access, including costs of extending a facility, but not costs associated with losses arising from increased competition in upstream or downstream markets: 6(4)(i)(ii);
- the economically efficient operation of the facility: 6(4)(i)(vii); and
- the benefit to the public from having competitive markets: 6(4)(i)(viii).

In this context, the Council considers that while clause 6(4)(i) lists the effects of regulated access on pre-existing contracts as relevant, this needs to be considered in the context of achieving a balance between a range of considerations. For instance, in considering access tariffs, the Council considers that clause 6(4)(i) points towards access tariffs that deliver an appropriate balance between a range of (sometimes conflicting) interests, including the interests of investors, consumers, access seekers, and existing contract holders. Clauses 6(4)(i):(ii), (vii) and (viii) in particular point strongly towards efficient, cost-reflective pricing that promotes efficient resource allocation and competitive markets. The Council notes, however, that these objectives need to be balanced against the remaining clause 6(4)(i) principles, including the legitimate business interests of the access provider and the interests of other parties. In this sense, the effects of regulated access on pre-existing contracts should not be viewed in isolation, but as one of many relevant considerations. For example, it may not be appropriate to consider an access regime as effective purely because it preserves pre-existing contracts, without considering wider effects of the access regime on economic efficiency and competition.

With these considerations in mind, the Council makes the following general observations. The National Gas Code relates to the use of spare and developable capacity in gas pipelines. The Code does not alter foundation contracts or any other pre-existing contracts. In particular, ss.2.25 and 6.18 preclude the regulator and arbitrator respectively from making a determination that would deprive any person of a pre-existing contractual right.[18]

The Council accepts that, should the Queensland Regime not be certified as effective, access to services covered by the regime may be open to a declaration application. Under s.44W(1) of the TPA, the ACCC may not make a determination that would prevent a person from exercising a contractual right to a sufficient amount of a service that would meet the person's actual

[18] Other than an exclusivity right that arose on or after 30 March 1995.

requirements. In addition, a right under contract in force prior to 30 March 1995 may not be set aside.

The Council observes that the risk of declaration applies to any service that is not already the subject of an effective access regime: s.44H(4)(e) of the TPA.

Compliance costs

In a submission to the Council, APT raised concerns that compliance costs in developing an access arrangement for s.58 pipelines would be at least $300,000 per pipeline, and that additional costs would be incurred by governments, regulators and pipeline users. APT argues that these costs would outweigh any benefit that might arise from regulation. APT cites a precedent in which the ACCC agreed to delay regulatory processes on a Northern Territory pipeline until usage of the pipeline expands (APT submission 2000).

The Council is cognisant of the compliance and regulatory costs involved in access regulation. While the clause 6 principles do not make explicit provision on this matter, the Council assumes that governments took account of public interest considerations in their original decisions to cover particular pipelines under Schedule A of the National Gas Code.

The Council notes that the extent of compliance costs may be overstated to some degree in this instance. This is because s.58 of the QGPAA does not exempt relevant service providers from submitting an access arrangement to the regulator for approval. However, the derogation on pricing matters would certainly reduce compliance costs to a significant degree.

The Council further notes that compliance with the National Gas Code is likely to bring benefits as well as costs. The benefits are likely to include greater confidence among market participants in regulatory outcomes and (perhaps) a shift towards more efficient pricing outcomes. These outcomes in turn are likely to promote the efficient use of infrastructure services. The Council is not in a position to weigh these benefits against the costs asserted by APT. Such an assessment would also need to take account of the duration of the derogations.

To address situations where access regulation is contrary to the public interest, the Queensland Regime allows parties to seek revocation of coverage of a pipeline: s.1.9 of the National Gas Code. The process requires an explicit consideration of public interest considerations. The Council considers this to be an appropriate forum to assess whether access regulation is justified in relation to particular pipelines.

4.2.2 Clause 6 principles: clause by clause assessment

This section provides the Council's assessment of the Queensland Regime against each of the clause 6 principles, taking account of public submissions received, discussions with interested parties, technical advice where relevant, new material forwarded to the Minister in 2001, as well as other relevant material that had not been available at the time the Council forwarded its original recommendation in February 2001.[19] In some instances, the Council has been obliged to draw on material that cannot be released publicly, due to confidentiality concerns. The Council identifies these instances in the body of the report.

Clause 6(3)

For a State or Territory access regime to conform to the principles set out in this clause, it should:

(a) apply to services provided by means of significant infrastructure facilities where:

   (i) it would not be economically feasible to duplicate the facility;

   (ii) access to the service is necessary in order to permit effective competition in a downstream or upstream market; and

   (iii) the safe use of the facility by the person seeking access can be ensured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist.

(b) incorporate the principles referred to in subclause (4).

Background

Clause 6(3) sets out threshold criteria that limit the scope of effective access regimes to a narrow range of infrastructure services.

[19] The additional material includes public submissions to the ACCC's regulatory processes on access arrangements for pipelines covered by the Queensland Regime, and public submissions received in response to the February 2002 draft recommendation.

The Queensland Regime

The Queensland Regime applies to the services of spare and developable capacity in natural gas pipelines that are 'covered' under the National Gas Code. It does not apply to upstream facilities or services of upstream facilities such as processing facilities or gathering lines.

'Service' and 'pipeline' are defined terms in the Queensland Regime (see section 3.2 of this report).

'Coverage' of a pipeline makes it subject to the obligations of the National Gas Code. The Code contains four coverage mechanisms (and a revocation mechanism) and sets out coverage criteria that closely reflect clause 6(3)(a) of the CPA. In addition, Queensland's access legislation covers three pipelines through legislative derogations: s.57 of the QGPAA.[20] An outline of the various coverage mechanisms and coverage criteria appears at section 3.2 of this report.

Queensland seeks certification of its access regime in relation to the services of natural gas transmission and distribution pipelines:

- that are included in section 57 of the QGPAA;
- that are specified in Schedule A of the GPAL as being under Queensland's jurisdiction (and are thus covered from the outset of the regime); and
- that subsequently become covered by the Queensland Regime.

Table 1 (section 3.2 of this report) lists pipelines covered under the Queensland Regime as at January 2002. Routes for existing transmission pipelines can be viewed on the map appearing at Figure 1 in section 3.1 of this report.

Issues and analysis

In its assessment of the National Gas Code (NCC 1997), the Council noted with respect to clause 6(3)(a)(i) that construction of natural gas pipelines involves large capital outlays and relatively low variable operating costs – resulting in significant economies of scale which can act as a natural barrier to competition. This means that natural gas pipelines have tended to have natural monopoly characteristics. However, the Council noted that this is not necessarily the case for all existing pipelines and that the situation may change over time as markets evolve.

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[20] Pipelines covered by s.57 of the QGPAA are: pipelines 32, 41 and the PNG-Queensland pipeline. See: Table 1 in section 3.2 of this report.

The Council noted with respect to clause 6(3)(a)(ii) that access to the services of gas pipelines may promote competition in upstream and downstream gas sales markets. The Council was not aware of safety issues arising under 6(3)(a)(iii) with regard to the National Gas Code framework.

With respect to the Queensland Regime, the Council understands that the list of pipelines covered from the outset was developed following consideration of each pipeline against the coverage tests in s.1.9 of the National Gas Code. The Council further notes that under s.1 of the Code, coverage of additional services requires the Council to make an independent and transparent assessment of the merits of coverage against the s.1.9 criteria. The Council observes that the s.1.9 coverage criteria closely reflect clause 6(3)(a) of the CPA.

In addition, the National Gas Code's revocation provisions enable parties to seek an independent assessment of whether the coverage principles continue to apply to a particular pipeline. These provisions ensure that should the clause 6(3) principles no longer apply, coverage may be revoked. The provisions were applied in 2000 when the owners of four Queensland pipelines applied for revocation of coverage. Following a public process, the Council concluded (and the Minister agreed) that the coverage criteria were no longer satisfied with respect to the four pipelines.[21]

The Council found in September 1997 (with respect to the National Gas Code) and in 1998 (with respect to the South Australian application of the Code) that the National Code framework satisfies clause 6(3).

The Council notes that the Queensland Regime covers three pipelines through legislative derogations at s.57 of the QGPAA. The Council understands that Queensland covered these pipelines following consideration of each pipeline against the coverage tests in s.1.9 of the National Gas Code. No concerns have been raised with the Council that coverage of these pipelines raises issues under clause 6(3).

The Council concludes that the Queensland Regime satisfies clause 6(3).

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[21] The relevant pipelines are: Kincora to Wallumbilla transmission pipeline; Dawson Valley to Duke transmission pipeline system; Moura Mine to Duke transmission pipeline system; the Dalby distribution system.

Clauses 6(4)(a)-(c)

A State or Territory access regime should incorporate the following principles:

(a) Wherever possible third party access to a service provided by means of a facility should be on the basis of terms and conditions agreed between the owner of the facility and the person seeking access.

(b) Where such agreement cannot be reached, Governments should establish a right for persons to negotiate access to a service provided by means of a facility.

(c) Any right to negotiate access should provide for an enforcement process.

Background

The Council considers clauses 6(4)(a)-(c) together, since jointly, they establish a framework for negotiations to proceed in an effective access regime. Clause 6(4)(a) establishes commercial negotiation as a cornerstone in determining access outcomes. This principle is complemented by clauses 6(4)(b) and (c), which recognise the need for underpinning regulatory measures where a service provider has considerable market power. In this sense, clauses 6(4)(a)-(c) require an appropriate balance between commercial negotiation and regulatory intervention to facilitate credible access negotiations.

The Council recognises that independent regulatory guidance to third parties may be needed to create an environment conducive to effective negotiations. This is especially true of industries where third parties have limited information on which to base negotiations or where many disputes are likely. In such circumstances, third parties may lack sufficient information and bargaining strength to negotiate reasonable terms and conditions, and credible pricing structures may only emerge through lengthy and potentially costly arbitrations. This prospect would be inimical to a genuine negotiation process.

To address these issues, regulatory processes should address information and market power asymmetry to give third parties a workable platform from which to enter negotiations. In the absence of such measures, an access regime may establish a right to negotiate in theory, but may put third parties in a position of negotiating blindly with a monopoly provider or of being offered potentially inappropriate prices on a “take it or leave it” basis. The latter may amount to a constructive denial of access, and cannot be viewed as satisfying 6(4)(a)-(c).

Addressing information and market power asymmetry is likely to require, among other things, independent guidance on appropriate access prices or price boundaries. An alternative may be to determine terms and conditions of access through a robustly competitive process, subject to independent oversight.

In considering whether an access regime provides appropriate guidance to market participants, the Council focuses, in the first instance, on whether regulatory processes are sufficiently robust to make that guidance credible. In particular, market guidance should be independent, and developed through open and transparent processes that allow stakeholders to participate, and provide them with reliable information to inform their views. Regulatory processes should be derived from appropriate legislative underpinnings, rather than being applied on an ad hoc basis, and should be clearly defined and made publicly available, to allay concerns of bias or perceptions of agreements made "behind closed doors."

While the clause 6 principles do not specify particular outcomes, they provide that outcomes should strike a balance between a range of factors including the legitimate business interests of the access provider, the interests of other parties, the delivery of cost-related pricing, the efficient use of infrastructure, and the public benefits arising from competitive markets: clause 6(4)(i).

The clause 6 principles recognise the need for an independent arbitration mechanism (clauses 6(4)(g)-(h)) to complement the negotiation/regulatory framework. In considering clauses 6(4)(a)-(c), the Council is conscious that the dispute resolution framework will affect the environment for negotiation. In particular, parties are more likely to engage in genuine negotiations if a robust arbitration mechanism is available to settle disputes.

The Queensland Regime

Under the Queensland Regime, parties are free to negotiate access within the regulatory framework of the National Gas Code.[22] The Code addresses market power issues by providing guidance in the form of access arrangements approved by an independent regulator. An access arrangement includes reference tariffs verified through open and transparent regulatory processes or through a regulator-approved competitive tendering process. Third parties are entitled to gain access to reference services at the reference tariff.

Disputes may be referred to the regulator, who may then arbitrate and set the terms and conditions of access. However the regulator may not deviate from the reference tariff in a dispute over the price of a reference service.

The Queensland Regime incorporates a number of derogations from the National Gas Code that limit the Code's application with regard to major transmission pipelines. Instead, regulatory arrangements set out in ss.58-59 of the QGPAA apply. In addition, the regime includes transitional arrangements to phase in the Code's operation.

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22 This framework is modified for s.58 pipelines.

The framework for negotiating access under the Queensland Regime is outlined in greater detail at section 3.3 (application of the National Gas Code) and 3.4 (Queensland's derogations and transitional arrangements) of this report.

Issues and analysis

The Council has previously found that the broad framework of the National Gas Code provides a balance between commercial negotiation and regulation under clauses 6(4)(a)-(c). The model of enforceable access arrangements approved by an independent regulator provides an appropriate platform for third parties to enter commercial negotiations, with binding dispute resolution available to settle disputes (NCC 1997, 1998).

In particular, the Code provides price guidance in the form of reference tariffs set through independent regulatory processes (or competitive tendering arrangements with independent regulatory oversight). Such guidance is made credible by the use of independent and transparent regulatory processes.[23]

The Council's 1997 report on the National Code noted that a proper 6(4)(a)-(c) assessment of State applications of the Code would also require consideration of State-specific features. In particular, the Council would need to consider:

- whether State-specific regulatory and appeals bodies are independent and adequately resourced to fulfil their functions; and
- whether State-specific transitional arrangements and derogations are consistent with the clause 6 principles.

The Council considers these matters below.

1 Independence of regulators and appeal bodies

The Queensland Regime gives considerable power to regulatory bodies. To ensure that all parties can be confident in regulatory processes, it is important that regulatory bodies undertake their duties in an impartial and objective manner; in other words, regulators must be independent and undertake open and transparent processes.

The Council has stated in previous certification processes that the essential criteria for independence is an arms length separation from facility owners, current users, access seekers, governments and other stakeholders (NCC 1997, p.17; NCC 1999a, p.18; NCC 1999b, pp.21-22). A government minister

[23] In Queensland, this framework is modified for s.58 pipelines.

or department is not appropriately independent for the purpose of access regulation due to the potential for conflicts of interest to arise.

The Council considers that regulatory bodies should enjoy a separate legal mandate, with freedom from day-to-day ministerial control in exercising regulatory functions. The Council regards this degree of independence as necessary to avoid the reality or perceptions of conflicts of interest, and so engender confidence that regulatory guidance is free of bias.

Under the Queensland Regime:

- the Australian Competition and Consumer Commission (**ACCC**) is the regulator for all transmission pipelines;
- the administrative appeal body in relation to decisions made by the ACCC is the Australian Competition Tribunal (**the Tribunal**);
- the judicial review body for decisions of the ACCC is the Federal Court, under the *Administrative Decisions (Judicial Review) Act 1977 (Commonwealth):* ss.20-21 of the QGPAA;
- the regulator of distribution pipelines in Queensland is the Queensland Competition Authority (**QCA**);
- the administrative appeals body for decisions made by the QCA is the Queensland Gas Appeals Tribunal (**QGAT**); and
- the judicial review body for decisions of the QCA is the Supreme Court of Queensland under the *Queensland Judicial Review Act 1991.*

ACCC and Australian Competition Tribunal

The Council has previously considered the independence and resourcing of the ACCC and the Tribunal and considers that they are sufficiently resourced and independent to properly carry out their tasks under the Queensland Regime (NCC 1999a, p.18; NCC 2001b, p.15).

QCA and QGAT

The QCA was established under the *Queensland Competition Authority Act 1997.* Under clause 8 of the Act, the QCA is a body corporate and may sue and be sued in its corporate name.

Clause 17 of the QGPAA provides that the QCA, in its capacity as regulator of gas distribution pipelines, may only perform the functions and exercise the powers conferred on it under the National Gas Code. Clause 17 also provides that in its capacity under the QGPAA, the QCA is not subject to Ministerial direction in relation to the exercise of its powers. In its regulatory role under the Queensland Regime, the QCA is required to undertake open and transparent processes.

The QGAT is established under Part 4 of the QGPAA. Under clause 24, the QGAT has the powers conferred on a local appeals body under the National Gas Code. The Premier nominates the chair and a pool of five panel members, having regard to knowledge and understanding of the gas industry. Members of the tribunal are appointed by the Governor in Council under the QGPAA. Queensland states that the QGAT and its members are "independent by virtue of their having similar appointment and dismissal provisions as the judiciary" (Qld Govt 2000a, p.14). Members may only be dismissed if they are mentally or physically incapable of satisfactorily performing their duties or if the member has neglected their duties or been incompetent or inefficient: s.28 of the QGPAA.

Clause 30 of the QGPAA provides for the appointment of a registrar and other staff to assist the Tribunal. The Act also sets out provisions on the conduct of reviews and disclosure of interests by members of the tribunal.

The Council's public consultation process did not query the independence of the QCA or QGAT. The Council is satisfied that they are independent for the purposes of clauses 6(4)(a)-(c).

The Council notes that the Queensland Regime limits the role of the ACCC for several transmission pipelines. Instead, regulatory arrangements in ss.58-59 of the QGPAA apply. The Council gives separate consideration to this matter below.

2 Section 58 derogations

S.58 of the QGPAA establishes derogations from the National Gas Code, affecting major transmission pipelines ("**s.58 pipelines**") in Queensland. The affected pipelines are listed in Table 3 in section 3.4.1 of this report. Background information on the pipelines is provided in Box 1 in, section 3.4.1 of this report, with a map of pipeline routes at Figure 1 in section 3.1.

S.58 quarantines the affected pipelines from compliance with tariff-related features of the National Gas Code, including:

- regulatory processes for setting reference tariffs;
- reference tariff principles;
- regulatory review arrangements; and
- provision of information to third parties on the derivation of reference tariffs.

Instead, alternative regulatory arrangements apply. In particular:

- "derogated" reference tariffs and related matters are approved by the Queensland Minister for Mines and Energy. The Council understands that the derogated tariffs are pre-existing tariffs originally approved by

the Queensland Minister prior to implementation of the National Gas Code. The original approvals occurred between 1995 and 1997 under Part 8 of the *Petroleum Act (Queensland) 1923 (***Petroleum Act***);* and

- for pipelines 2, 30 and 41, pipeline owners are not required to provide information to access seekers on the derivation of reference tariffs.

The Minister-approved tariffs will remain in force for periods of up to 25 years, depending on the review date for the access arrangement of each pipeline. Once a derogation expires, the pipeline will become subject to the regulatory framework of the National Gas Code.

The Council notes that the s.58 arrangements do not alter the National Gas Code framework of allowing parties to negotiate terms and conditions of access, with arbitration available to settle disputes on non-price matters and the pricing of non-reference services. In addition, the s.58 arrangements provide guidance to third parties in the form of a published access arrangement, including reference tariffs for reference services (benchmark prices for services likely to be sought by a significant part of the market). As per the National Gas Code, third parties are entitled to acquire access to spare capacity in a s.58 pipeline at the reference tariff, and the tariffs for reference services cannot be varied in arbitration.

Apart from reference tariffs and tariff-related matters, the National Gas Code applies to s.58 pipelines, with the ACCC as regulator. For example, National Code requirements such as ring fencing arrangements, regulatory approval of access arrangements, and dispute resolution procedures, are not varied by the derogations.

The Council has previously recommended that the regulatory processes in the National Gas Code satisfy clauses 6(4)(a)-(c), and to the extent that the s.58 arrangements replicate this framework, the Council sees no need to reconsider the effectiveness of those aspects of the regime.

The Council now turns to those aspects of the s.58 arrangements that have not previously been assessed against clause 6. The principal areas requiring consideration are regulatory processes for setting reference tariffs, the provision of information to third parties, and the period for which the regulated tariffs apply.

A threshold issue under 6(4)(a)-(c) is whether regulatory arrangements for s.58 pipelines provide a viable basis for third parties to enter access negotiations. In particular, the Council must consider whether the arrangements provide appropriate guidance to market participants to address the information and market power asymmetries that can arise in natural monopoly infrastructure markets. The Council notes in this regard the following comments by Ergon Energy:

> *Negotiating with a monopoly business in relation to the terms and conditions upon which access to infrastructure is granted is a difficult task. Commercial outcomes and appropriate apportionment of risk*

> *between the Service Provider and User are seldom achieved under agreements due to the relative (ie inequitable) bargaining positions of the parties. (Ergon Energy 2001, p. 4).*

For the purposes of clauses 6(4)(a)-(c), the Council must consider whether the regulatory processes for setting s.58 tariffs were appropriate. In making its assessment, the Council focuses on whether underpinning regulatory processes are sufficiently robust to make that guidance credible. In particular, guidance should be independent and developed through open and transparent processes.

The Council notes in this regard that the s.58 framework does not establish new regulatory processes to assess reference tariffs. Instead, s.58 acts to preserve the outcomes of regulatory processes that occurred several years previously. In this sense, the relevant regulatory processes for the Council's consideration are the original processes that set the derogated tariffs. These processes occurred mainly between 1994 and 1997, under the *Petroleum Act 1923*.

The historical nature of the original regulatory processes has posed difficulties for the Council in identifying what transpired several years ago. The Council sought the advice of the ACCC to clarify the nature of these regulatory processes, and has relied to some extent on the information provided.[24] The Council notes, however, that the ACCC had limited access to relevant material. No information was made available by the pipeline owners, and little detail was available on tendering processes for pipelines 24, 30 and 41. The ACCC also reported a shortage of detail on "economic evaluations that may have taken place at the time." (ACCC 2000). The Queensland Government has disputed some aspects of the ACCC report (Qld Govt 2000b).

The Council also took into account information provided by Queensland on a confidential basis in response to the Council's draft recommendation. Given the confidential nature of the information provided, the Council is limited in its ability to directly refer to the material in this final recommendation.

The Council outlines regulatory processes for s.58 pipelines, to the best of its understanding, in Boxes 2-4.

24 Under the terms of reference for this report, the ACCC assessed regulatory processes for s.58 pipelines against the benchmark of the National Gas Code. The Council notes that an effective access regime does *not* need to replicate the outcomes of the National Gas Code. But while the National Gas Code is not a determinative benchmark for an assessment against clause 6, it nonetheless offers some guidance, in that the Code has been found to be an effective access regime for gas pipeline services. With this in mind, the Council has made use of some factual material in the ACCC report to inform its understanding of regulatory processes for s.58 pipelines.

Box 2 **Pipeline 2: Roma to Brisbane, RBP**

The RBP was commissioned in 1967 to meet the energy needs of the utility distribution systems and major industrial and power generation facilities in southeastern Queensland and the Brisbane metropolitan area. The original capacity was 78.9 TJ/day. The RBP has since undergone considerable expansion with the installation of compressors between 1981 and 1986 and through progressive looping which commenced in 1998. The RBP has now been almost entirely looped. The looped pipeline sections are capable of running at higher pressure than the original pipeline and are larger with a sixteen inch diameter.

In addition to the looping, compressors have been added upgrading the capacity of the RBP to approximately 145TJ/day. The RBP has had little spare capacity for many years, since APT has incrementally looped the pipeline in stages to increase capacity only by the exact quantity of new contracts.

Reference tariffs for pipeline 2 are pre-existing tariffs originally approved by the Queensland Minister for Mines and Energy in 1996, following regulatory processes conducted by the Queensland Government under Part 8 of the *Petroleum Act 1923*.

Stage 1: capacity up to 78.9 TJ/day

In 1995, the RBP had a capacity of 78.9 TJ/d. Access principles for this tranche of capacity (Stage 1 of the pipeline) were developed by the pipeline owners and submitted to the Queensland Department of Mines and Energy (**QDME**) for approval under Part 8 of the *Petroleum Act 1923*. At the time, the pipeline was operating at full capacity with contracts in place reserving all the available capacity. The ACCC has reported that all capacity on tranche 1 remains contracted until at least 2006.

Queensland sought advice on an appropriate rate of return on the pipeline from the Queensland University of Technology. It also conducted public consultation on the proposed access principles, but with very limited information disclosure to interested parties. In particular, it appears that users were not provided with a breakdown of costs to help them form a view on proposed cost allocations.

The pricing proposals underwent many adjustments during negotiations between AGL and QDME. The final result, as reflected in the approved access principles, was determined by QDME, which appears in some areas (mainly non tariff-related) to have taken account of the views of stakeholders. However public consultation does not appear to have had a major bearing on tariffs. The approved average tariff appears to have been negotiated between the Government and AGL *prior* to the development of the draft principles. This agreement appears to have taken place during the South West Queensland pipeline (pipeline 24) tender selection process (ACCC 2000, p.29).

QDME conducted its own assessment of the agreed tariff and reported that it translated into a rate of return that was more likely to be "unreasonably high" than "unreasonably low." The Minister for Mines and Energy nonetheless approved the tariff in 1996. (ACCC 2000, p.31).

Stage 2: capacity from 78.9 to 101 TJ/day

When AGL sought permission to expand the capacity of pipeline 2 in the mid-1990s, a separate set of access principles was developed to cover the expansion from 78.9 to 101 TJ/d (Stage 2). As for Stage 1, most of the new capacity was already under contract.

The Stage 2 access principles were approved in November 1997. Cost recovery is by way of a surcharge payable in addition to the capacity reservations and throughput charges in Stage 1.

Once again, QDME sought public comment on the draft access principles prepared by AGL. As before the information provided to stakeholders was limited to that contained in the stage 2 draft and an accompanying "worked example." Information was not made available on costs, load factors or other assumptions to enable parties to make an assessment of the surcharge. As for Stage 1, users were not provided with a breakdown of costs to assist them form a view on the cost allocation proposed. As such, third parties may have lacked the necessary information to provide informed comment.

In the absence of cost and other data, the ACCC reported some confusion among stakeholders as to whether the surcharge amounted to "double dipping," given that the base load capacity rate was also to be paid by incremental capacity users.

Stage 3 and beyond: capacity in excess of 101 TJ/day

Pipeline 2 has been subject to ongoing expansions, each subject to a separate set of access principles that operate concurrently. The Council has been informed that the total number of access arrangements for the pipeline could expand to six. In an access arrangement proposed by APT to the ACCC in 2000, capacity was listed as 118.5 TJ/day. The ACCC noted in 2001 that current pipeline capacity is up to 145 TJ/day.

The Council understands that the original intent of the Queensland Government was that reference tariffs for capacity beyond 101 TJ/day would be fully subject to the National Gas Code. However, the ACCC has received legal advice that it is unable to set reference tariffs for capacity beyond 101 TJ/day. The wording of s.58 of the QGPAA effectively designates the Minister-approved tariffs as the only reference tariffs that can apply to the pipeline.

As such, there are no 'reference services' for capacity beyond 101 TJ/day, and APT has not submitted reference tariffs for approval to the Queensland Government or the ACCC. In effect, price guidance is not offered for capacity above 101 TJ/day.

APT's proposed access arrangement refers to capacity beyond 101 TJ as a 'negotiated service.' It remains open to parties to use the National Code's arbitration provisions to gain access to capacity above 101 TJ/day.

These arrangement will remain in place until June 2006.

Principal sources: ACCC 2000 (including sections that the Council is unable to release publicly due to confidentiality constraints), ACCC 2002a, Qld Govt 2001.

Box 3 **Pipeline 30: Queensland Gas Pipeline, QGP**

Reference tariffs for the QGP were approved by the Queensland Minister for Mines and Energy, following tendering arrangements conducted by the Queensland Government.

The QGP was commissioned by the Queensland Government in 1989. The Government sought tenders to sell the pipeline in November 1995, setting a reserve price of $111 million. Bids closed in February 1996, with four conforming bids received. The pipeline was sold to PGT in July 1996 for $162 million. PGT's assets in Australia were sold to Duke Energy Australia in 1998.

The tendering process developed and run by the Queensland Government was designed to simultaneously privatise the pipeline and determine access tariffs. The Queensland Government has informed the Council that precautions were taken to ring fence the process for approving access principles – involving the Minister and a regulator within QDME – from the tender evaluation group, which included representatives of Treasury and QDME. Queensland states that:

> *Staff within the regulatory area had no participation in or knowledge of the evaluation processes. The regulatory group responded to draft access principles lodged by the preferred tenderer, after the selection process had been completed. (Qld Govt 2000b, p.4)*

The documents available to the ACCC provided little detail on the tendering process used. The ACCC reports that there appears to have been little consultation with stakeholders on this matter, although the Evaluation Committee sought comment from major customers of the pipeline when they were trying to choose between the shortlisted bids.

While selection criteria were made available to interested parties, the ACCC reported a lack of evidence to determine whether the successful tenderer was chosen on the basis of those criteria. In the ACCC's view, the selection criteria appear to have been designed to determine a party that the Government could undertake further negotiations with, rather than as a process to determine the tariffs.

It appears that the selection process was not a competitive process to obtain the most competitive tariff *per se* Instead, the successful bidder appears to have been chosen on the basis of a trade-off between maximising sale price of the pipeline and achieving reasonable tariffs. The Queensland Government stated in 1995 that an objective of the sale was, among other things, "the achievement of a satisfactory sale price with a tariff regime structured to support a bid price above the disclosed reserve price." Subsequently, Queensland stated that an internal report on the regulatory process previously submitted to the ACCC recognised that the "tariff structure is therefore the main aspect of gas market development" and was a significant outcome of the process (Qld Govt 2002). The ACCC found that the selection process favoured tariff increases (which would also increase the sale price) where demand was inelastic (ACCC 2000, pp.10-11). In contrast, Queensland informed the Council that during the sale process, it was emphasised in discussions with bidders that the State was less interested in maximising the sale price than ensuring that tariffs to the Gladstone and Rockhampton mineral processing regions were as low as reasonably possible (Qld Govt 2002).

The Queensland Government informs the Council that QDME agreed with the proponent various improvements to the draft access principles arising from tender, following which they were released for public comment. The draft access principles (dated 1 April 1996) were made available to 40 interested parties, including the unsuccessful bidders for the pipeline. Of these, 12 made submissions. The ACCC reported a lack of detailed information provided to interested parties, from which they could develop comments. The regulatory process also included a detailed evaluation by QDME.

Queensland informs the Council that public comments were taken into consideration and improvements agreed with the proponent before the Minister approved the access principles in July 1996.

Sources: ACCC 2000 (including sections that the Council is unable to release publicly due to confidentiality constraints), Qld Govt 2000b.

Box 4 **Pipeline 24: South-West Queensland Pipeline, SWQP** and **Pipeline 41: Carpentaria Gas Pipelines, CGP**

Reference tariffs for pipelines 24 and 41 were approved by the Queensland Minister for Mines and Energy following tendering arrangements conducted by the Queensland Government.

The Queensland Government effectively ran a single regulatory process for the SWQP and CGP. In February 1994, the Government called for tenders to develop a pipeline from Ballera to Wallumbilla, or possibly Brisbane. During that process, the scope was widened to include a pipeline from Ballera to Mt Isa. Three parties were shortlisted and then asked to submit more detailed proposals from which the final selection for each pipeline was made.

The documents available to the ACCC provided "little detail on the tender process used and even less of economic evaluations that may have taken place at the time."

The Council understands that the tendering process was developed principally by the office of the Co-ordinator General (OCG), working to the Special Purpose Cabinet Committee (Natural Gas Strategy).

In the ACCC's view, the selection process appears to have been developed and refined as it proceeded, rather than determined and clearly communicated to prospective participants up-front. Prospective bidders do not appear to have been told what the selection process would entail for short-listed parties until after the initial registration of interest process. At a briefing session for those parties, they were given the shortlisting critical evaluation criteria. The ACCC reports that the Government then began to impress on the parties that its focus was on the delivered cost of gas, rather than the pipeline transmission tariff.

The ACCC reports that a feature of the regulatory process was a lack of detailed information provided to interested parties. It appears that comments were not sought from interested parties on a proposed tender process, and that the only comments sought on the process were from prospective bidders during the second round of shortlisting. At that stage, the Government invited parties to propose alternative arrangements to a wide range of aspects, including "the process of shortlisting itself."

A feature of the tendering process was that the Government continued to entertain a proposal from one party (Santos) after it failed to be shortlisted. The Government informed the three short-listed parties that this was the case.

In the final selection round, the Government provided the shortlisted parties with a Terms of Reference. This included a statement of the Government's objectives in undertaking the process and the selection criteria that would be used to rank the proposals. The Terms of Reference indicate that the primary selection criteria would be the lowest "packaged delivered gas price". The Council notes that this would include the commodity cost of gas and potentially also the cost of transportation on another pipeline to Brisbane. Queensland disputes that this selection criteria was actually used (Qld Govt 2000b, p.4).

The ACCC reported that, arguably, there was a degree of separation between the Gas Committee (which analysed the three shortlisted bids) and the Queensland Cabinet (which made the final decision on a preferred developer). The Government also engaged an independent consultant (Bain and Company) to analyse the shortlisted bids to compare with Queensland Treasury analysis. These were compared by the tender assessment working group, which submitted its recommendation to the Gas Committee.

Queensland awarded the SWQP tender to Tenneco, and the CGP tender to AGL. From the limited material available to the Council, the reasons for the Queensland Government selecting AGL ahead of other competing bidders are not clear.

The tariff regime for pipeline 24 was agreed between the parties on 28 February 1995. Access principles (and the license) for the pipeline were approved by the Queensland Government in January 1996 under the Petroleum Act. The pipeline was constructed in 1996 and ready for operation late in 1996.

Access principles for pipeline 41 were initially agreed between the parties on 24 May 1995, when a formal agreement was signed. The principles were subject to a number of amendments and approved on 20 March 1997, with commissioning one year later.

The ACCC was unable to view the winning tenders to determine whether there were significant changes between the tendered tariffs and those set out in the final access principles. Queensland informed the Council that the agreed access principles reflected the tendered tariffs (Qld Govt 2002). Queensland has informed the Council that copies of the draft access principles were made available to interested parties on request. It is not clear whether any amendments were made in response to stakeholder concerns.

Sources: ACCC 2000 (including sections that the Council is unable to release publicly due to confidentiality constraints), Qld Govt 2000b.

Independence of the regulator

Reference tariffs for pipelines 2, 24, 30 and 41 were approved by the Queensland Minister for Mines and Energy in the year 2000 under s.58 of the QGPAA. The Council understands that the approved tariffs preserve pre-existing tariffs approved by the Minister between 1995 and 1997 under the *Petroleum Act 1923*.

In each case, the “regulator” responsible for approving the tariffs (both in the mid 1990s and again in the year 2000) was the Queensland Minister, acting on the advice of the Queensland Department of Mines and Energy (**QDME**). An issue raised in submissions is whether the Queensland Minister and his department were appropriately independent to act in this role.

Elsewhere in its assessment against clauses 6(4)(a)-(c), the Council states its view that independent regulatory guidance to third parties may be needed to create an environment conducive to effective access negotiations. The Council has also explained its view that a government minister or department will not be appropriately independent for the purpose of access regulation due to the potential for conflicts of interest to arise.

The Council considers that the source of regulatory guidance to market participants has a significant bearing on to its credibility. Unless the veracity of price and other information is vetted through independent processes, there is a risk that it may be misleading or biased in favour of particular interests. Perceptions of bias would taint regulatory guidance, which would run counter to the rationale of addressing market power and information asymmetry. Without reliable information, third parties are likely to be ill equipped to enter effective access negotiations.

Public infrastructure: pipeline 30

The potential for conflict when a government Minister acts as an access regulator is most apparent in the case of public infrastructure. For example, governments may face pressure to trade off efficient access prices for higher access charges that translate into higher asset values. The issue arose for pipeline 30, where the Government ran a process in 1995-96 to

simultaneously privatise the pipeline *and* determine access tariffs. Among the disclosed objectives of the sale were:

> *The achievement of a satisfactory sale price with a tariff regime structured to support a bid price above the disclosed reserve price (reported in ACCC 2000, p.10).*

Queensland argues that such a process is appropriate:

> *It might be argued that the Government could have achieved a lower tariff outcome by accepting a lower selling price. It could also be argued that the Government could have achieved a much higher selling price had the existing 1995 tariffs been maintained. It is our submission that the sale process was in fact concluded on a basis which struck an appropriate balance between the sale price achieved and the tariff outcomes (Qld. Govt. 2000b, p.5).*

The ACCC raised concerns that the process adopted by Queensland was open to internal conflict:

> *The Government had incentive on the one hand to seek to maximise the sale price of the pipeline, while on the other to obtain the lowest sustainable tariff for users. The Queensland Government required that tenderers submit a matrix of bids, with high purchase prices corresponding to high tariff rates and lower purchase prices corresponding to lower tariff rates. This effectively allowed the Queensland Government to choose its preferred trade off between sale price and tariff...*
>
> *In making the trade off between sale price and tariff, the Queensland Government was focused more on the level of demand than on the level of the tariff – such that if the demand was relatively inelastic, tariff increases that did not significantly decrease demand, but did increase the purchase price, were favoured in the selection process (ACCC 2000, p. 11).*

In contrast, Queensland argued that an internal evaluation report submitted to the ACCC with other details of the regulatory process, recognised that the “tariff structure [was] … the main aspect of gas market development” and was a significant outcome of the process. In addition, Queensland stated that during the sale process, it was emphasised in discussions with bidders that the State was less interested in maximising the sale price than ensuring that tariffs to the Gladstone and Rockhampton mineral processing regions were as low as reasonably possible (Qld Govt 2002).

Chevron, which was a potential user of the pipeline, echoed the ACCC’s concerns:

> *… the Government had a clear trade-off to consider when determining the winner of its “competitive process”: sale price versus tariff. There is no reason to be confident that the tariffs on the Duke pipeline are*

competitive and cost reflective. It could well be the case that the tariffs were inflated to support a higher selling price to the Government (Chevron submission, 1999)

The owners of s.58 pipelines (APT, Epic and Duke) acknowledge the potential for conflict:

In relation to the Wallumbilla to Gladstone via Rockhampton pipeline, there was a possibility that the process for awarding the tender would not guarantee the lowest possible tariffs since the Government had to balance tariffs against the sale price (Duke, Epic, APT 2001, p. 10).

Queensland agrees that the regulatory framework was open to a potential conflict:

The most important potential basis for conflict arises if the Minister, or the Government, owns the infrastructure the subject of regulation. In this circumstance, there would be scope for the Minister to have a goal of maximising asset value and a considerable argument for the economic regulation of the assets to be removed from Government, or strict ringfencing arrangements to be implemented (Qld Govt 2001, p.9).

While acknowledging the risk of conflict, the Queensland Government argues that precautions were taken to ring fence the Minister (and a regulator within QDME who administered the Act on a day-to-day basis) from the sale process:

With pipeline 30, a potential conflict situation did arise because the Government as owner was also setting the tariffs in conjunction with a sale process for the pipeline in 1996. This situation was addressed under the Petroleum Act 1923 *which required the decision making to be independent. The Regulator thus determined a regulatory process for approval of the Access Principles that clearly separated the regulatory process from the sale process (Qld Govt 2001, p.10).*

The Council notes that the Petroleum Act does not set explicit requirements or criteria for Ministerial independence. Queensland informs the Council that the necessary independence is achieved as follows:

The relevant sections that require decisions relating to access principles to be made by the Minister are: 70A(3)(a)(i), 109(3), 110(3), 112(3), 113(3), 114A(1), 114B.

The fact that the sections require a decision by the Minister, and only the Minister, implies the degree of independence expected. In making a decision, the Minister must act reasonably and in an unbiased manner. This is reinforced by the fact that any decision made under these sections is reviewable under the Judicial Review Act 1991 (Qld). *The objective of the Petroleum Act also places a general obligation on the Minister to act in the public interest.*

In addition, section 112(3) sets out specific matters that the Minister must consider in approving access principles. These matters are based on clause 6(4)(i) of the Competition Principles Agreement.

As a matter of practice, to ensure the Minister remained independent and unbiased in the regulatory decision-making process, he and the departmental officers advising him were ringfenced from the tender and sale processes associated with each pipeline.

The Council notes the arguments raised by Queensland, but remains concerned that regulatory independence should be established through explicit provisions rather an assumption of Ministerial independence.

The Council accepts that under Part 8 of the Petroleum Act, the Minister is directed to take account of the specific matters set out at s.112(3), but is concerned that this regulatory process should be undertaken by a body without a possible conflict of interest.

The Council also notes that regulatory decisions of the Minister under the Petroleum Act are open to judicial review, and Queensland's view that this helps to address independence concerns. The Council remains concerned, however, that judicial appeals can be costly and time consuming, placing an unnecessary burden on third parties. The Council considers that, to promote confidence in regulatory processes and avoid perceptions of bias, the independence of regulatory processes should be established as an "up front" matter.

The Council considers that while Queensland adopted safeguards to ring fence the approval of access principles from the sale process, the "regulator" responsible for these safeguards was nonetheless an employee of the Queensland Government, and may have been open to a conflict of interest regarding tariff outcomes. For this reason, the Council cannot be confident that the regulatory framework was independent.

Private infrastructure: pipelines 2, 24 and 41

Pipelines 2, 24 and 41 have always been privately owned. Queensland argues that, in this context, it is appropriate for a government minister to act in a regulatory capacity in setting terms and conditions of access:

Pipeline 2 is a privately owned pipeline and there is, therefore, no conflict arising as there is no incentive for the Government to maximise the asset value of this pipeline. The argument also applies in relation to pipelines 24 and 31 (Qld Govt 2001, p.9).

Forcenergy, a new entrant to the upstream sector, disagrees:

The so called competitive tendering process conducted in Queensland was between pipeline developers and the Queensland Government. The rest of the industry was precluded from the process. A government conducted tendering process does not represent market forces and

> *commercial outcomes. The process was highly political (Forcenergy submission 1999).*

The Council considers that, while a government minister is clearly open to conflict if acting as a regulator for public infrastructure, issues may also arise if the facility is in private hands.

For example, the clause 6 principles require that access tariffs strike an appropriate balance between a number of specified matters, including the owner's legitimate business interests and investment in a facility, efficient cost considerations, the efficient use of infrastructure and competitive outcomes: clause 6(4)(i).[25] But governments may attach different priorities to these matters, perhaps for political or wider public policy reasons; or may wish to use access regulation to pursue objectives that are in conflict with the 6(4)(i) considerations. The issue may arise for private, as well as public infrastructure.

The Council notes that an objective of regulatory processes for s.58 pipelines was to promote investment and regional development:

> *The two SWQ pipelines (ie. PL 24 and 41) have been developed recently on a "greenfields" basis with a view to enhancing the economic prospects of Queensland communities by facilitating future industrial and mining ventures (Qld Govt 2001, p.6).*
>
> *The arrangements were set in the context of encouraging private sector investment in major (new and existing) pipeline infrastructure essential to the development of the gas market (Qld Govt 200, p.18).*

Queensland argues that the pursuit of development priorities does not give rise to a conflict of interest in regulatory decisions on access:

> *A Minister's independence is not compromised if he or she wishes to facilitate economic development by ensuring the conditions/incentive for investment in infrastructure exist…(Qld Govt 2001, p.2)*
>
> *The regime should… not be penalised on the basis of an argument that a Minister may wish to facilitate economic development by way of creating the conditions/incentive for investment in infrastructure which has a net public benefit. That regulators… must take into account the impact of access regulation on investment incentives and must facilitate investment as a key objective of regulation is a key message of the recent Position Paper by the Productivity Commission.*
>
> *Clearly there is a need for safeguards against inefficient investment decisions and monopoly pricing and practices, and a need to deliver*

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[25] While the wording of 6(4)(i) implies that it be administered by an arbitrator, the Queensland Regime shifts responsibility for pricing matters to the regulator. See discussion in this report under clause 6(4)(i).

> *fair and reasonable prices to end-users. However this should be balanced against the potential for market driven investment in infrastructure to be a catalyst for broader economic development... When market-based returns (based on the riskiness of a project) are constrained by a regulated return, some projects may become privately non-commercial, even though they may still be economically viable from a social perspective (Qld Govt 2001, p.11)*

The Council considers it appropriate, under clause 6, for access tariffs to take account of such matters as the environment for investment and economic development. In particular, clause 6(4)(i) states that the terms and conditions of access should take account of a range of specified factors, including the owner's legitimate business interests and investment in a facility.

But while the environment for investment and appropriate returns to investors are relevant to price setting in an effective access regime, these objectives need to be balanced against several other considerations. In particular, clause 6(4)(i) lists the following considerations which are relevant factors in price setting:

- the costs to the owner of providing access, including costs of extending a facility, but not costs associated with losses arising from increased competition in upstream or downstream markets: 6(4)(i)(ii). The Council considers that this provision may point towards efficient cost-related pricing, with a view towards reducing or removing monopoly rents;

- the economically efficient operation of the facility: 6(4)(i)(vii). The Council considers that this provision points towards efficient access prices that encourage efficient usage of infrastructure, rather than monopoly pricing that may constrain demand; and

- the benefit to the public from having competitive markets: 6(4)(viii). The Council considers that this provision suggests that the public interest is likely to be best served through cost-reflective access prices that promote competition in other markets.

The Council notes that clauses 6(4)(i): (vii), (viii) and possibly (ii) point towards efficient, cost-reflective pricing that promotes efficient resource allocation and competitive markets. In this sense, the effects of access regulation on investment and economic development should not be viewed in isolation, but as one of many relevant considerations. For example, there is a risk that the pursuit of investment and development goals through access regulation *might* encourage Governments to trade off efficient tariffs for higher levels of investment (whether efficient or not). In this sense, the pursuit of investment and development goals through access regulation would need to be objectively balanced against the other 6(4)(i) considerations, including the effects on economic efficiency and competition.

More generally, the Council considers that clause 6(4)(i) requires a carefully balanced assessment of a number of often-conflicting matters. To deliver appropriate outcomes, the 6(4)(i) matters need to be weighed and judged by a

body without vested interests in a particular outcome. The Council would find it difficult to consider government ministers or departments as appropriately independent access regulators to make such assessments – either for private or public infrastructure.

The Council notes that for pipelines 24 and 41, the ACCC reported a degree of separation between the Gas Committee (that analysed the shortlisted bids) and Cabinet (which selected the preferred developer). The Council also notes the use of an independent consultancy to analyse the bids. Finally, Queensland reported that the access approval process was ring fenced from the tendering process to preserve independence. In particular, following completion of the selection process by the Office of the Co-ordinator General, the successful tenderer, through a separate process, then agreed access principles with the Minister for Mines and Energy. Queensland stated that the Minister had no active participation in the tender selection process up until this point (Qld Govt 2002).

Nonetheless, the Council remains concerned that the Queensland Government was responsible for both the tendering processes and approval of access principles, and that this regulatory framework is open to conflicts of interest.

Evolution of regulatory standards

The Council notes that most regulatory processes for s.58 pipelines were conducted between 1994 and 1997. Some parties have suggested that the timing of these processes is relevant to a consideration of appropriate standards of regulatory independence.

In particular, Queensland points out that standards of independence can evolve over time:

> *The process of having a government minister approve tariffs was acceptable in the absence at the time of statutory regulatory bodies performing the function of economic regulation. It is still an acceptable means of regulation, provided the right regulatory framework, ensuring independence and constraining the matters which may be taken into account, is in place. The Petroleum Act 1923 established such a process (Qld Govt 2001, p.10).*

The Council agrees that regulatory standards have, and will continue to evolve over time. However the Council also notes that clause 11.3 of the 1997 Gas Agreement requires that a regulator under the National Gas Code:

> *must at all times be an independent authority established by statute....*

While the 1997 Gas Agreement is not a relevant benchmark for assessing effectiveness against clause 6, the wording of the intergovernmental agreement suggests that by 1997 at least, Australian Governments may not have considered the regulatory standards adopted by Queensland as adequate for access regulation.

While the Council has some sympathy for Queensland's argument, the Council must apply clause 6 from the perspective of current approaches to regulation. An effective access regime should provide for future access negotiations to occur against a framework that is appropriate by today's standards. In this context, the Council cannot, on balance, be confident that the Queensland Minister is an appropriately independent body to provide regulatory guidance to third parties.

Were regulatory processes appropriate?

Elsewhere in this report (see: "Background" section on clauses 6(4)(a)-(c)), the Council notes that independence is one of many factors affecting the credibility of regulatory processes. Other relevant factors include:

- appropriate legislative underpinnings;
- openness and transparency of process; and
- the pursuit of appropriate outcomes.

The owners of s.58 pipelines (Duke, Epic, APT) agree that principles of transparency and the pursuit of efficient outcomes are relevant:

> *The access and tariff setting protocols in the* Petroleum Act *provided for transparent regulatory processes to determine efficient tariffs and to promote the public interest. These are key outcomes from the application of the CPA (Duke, Epic, APT 2001, p.3).*

The Council notes that reference tariffs for s.58 pipelines were approved under regulatory processes in Part 8 of the Petroleum Act. Owners of the s.58 pipelines argue that these regulatory processes were sound:

> *We submit that the derogations do satisfy the CPA principles as the access principles were either established through a competitive tender, or through an independent and transparent process with the aim of reflecting efficient access pricing (Duke, Epic, APT 2001, p.9).*

As background to its assessment of regulatory processes for s.58 pipelines, the Council provides a summary of the timing of regulatory processes on tariffs in Table 6. In Box 5, which follows, the Council outlines the relevant sections of the Petroleum Act, including modifications that occurred during the regulatory periods for s.58 pipelines.

Table 6 Regulatory timetable: reference tariffs for s.58 pipelines

Pipeline No.	*Regulatory process commenced*	*Regulatory process concluded (access principles approved)*
2 **Roma to Brisbane** **RBP** Stage 1 (up to 78.9 TJ/d) Stage 2 (78.9 – 101 TJ/d) Stages 3 + (beyond 101 TJ/d)	**September 1995** **19 June 1997** **no regulatory process has occurred on tariffs**	**29 July 1996** **28 November 1997**
24 **South West Queensland Pipeline** **SWQP**	**5 February 1994** tender process launched **December 1994** winning tender selected **8 April 1995** draft access principles agreed between parties; later subject to amendments	**12 January 1996**
30 **Queensland Gas Pipeline,** **QGP**	**3 November 1995** tender process launched **10 April 1996** winning tender selected **1 April 1996** draft access principles released for comment	**27 June 1996**
41 **Carpentaria Gas Pipeline** **CGP**	**16 May 1994** tender process launched as add-on to tender process for pipeline 24 **December 1994** winning tender selected **24 May 1995** tariff regime initially agreed between parties, later subject to amendments	**20 March 1997**

Sources: ACCC 2000, Qld Govt 2000b

Box 5 **Petroleum Act 1923: tariff setting provisions for s.58 pipelines**

Queensland informs the Council that regulatory processes for s.58 pipelines were originally conducted under Part 8 of the *Petroleum Act 1923*. These provisions commenced on 1 July 1995.

Part 8 sets out objectives, a requirement that access principles be submitted for approval, and matters the Minister must take into account before making a decision on proposed access principles. While the Act creates a right for the Minister to obtain necessary information, sets timeframes for the Minister's decision, and provides guidance on matters to consider, the Act does not set out specific regulatory processes (such as public consultation) that must be undertaken in the approval process. Similarly, the Act does not mandate regulatory processes that must be observed where access principles are determined through a competitive tendering process.

The Act was amended in December 1996 to give explicit recognition to the use of competitive tendering to award a pipeline license. The insertion of s.70A allows the Minister to approve access principles following such a process, provided the Minister is satisfied the selection process was competitive.

The December 1996 amendments also included specific provisions on pipelines 24, 30 and 41:

- s.151 provides that the pre-existing decisions to approve access principles for pipelines 24 and 30 are "valid, final and conclusive, cannot be challenged and are not subject to a writ or order of any court, tribunal, authority or person on any ground."
- s.152 provides that the Minister's decision to approve access principles for pipeline 41 is deemed to have occurred under s.70A, and declares that the Minister was satisfied a competitive selection process was completed for the grant of the pipeline license.

The Council makes the following general observations.

Access principles for pipeline 2 (tranches 1 and 2) were originally approved following regulatory processes that took place under Part 8 of the Petroleum Act. It was originally envisaged that reference tariffs for tranches 3 and beyond would occur under the National Gas Code. This has not been the case, however; no reference tariffs for tranches 3 and beyond have been approved under the Petroleum Act (or the QGPAA).

Regulatory processes for pipeline 30 took place under Part 8 of the Petroleum Act. These processes were completed before s.70A commenced (that is, before the Act gave explicit recognition to the use of competitive tendering processes to award a pipeline license and form the basis of an agreement with the Minister on access principles). S.151 provides that the decision to approve access principles for pipeline 30 cannot be challenged.

The tendering processes for pipelines 24 and 41 commenced and were completed prior to the existence of Part 8. Formal agreements on draft access principles were also signed prior to the commencement of Part 8.

The final approval of access principles for pipeline 24 occurred under the provisions of Part 8. S. 151 provides that the decision to approve access principles for pipeline 24 cannot be challenged.

The final approval of access principles for pipeline 41 is deemed to have occurred under s.70A. The provisions of s.152 deems that the selection process was competitive.

The Council observes that while Part 8 of the Petroleum Act directs the Minister to consider specific matters in approving access principles (s.112), considerable discretion is left to the Minister and QDME as to the conduct of regulatory processes. For example, the Council is not aware of specific requirements to conduct open and transparent processes, including public consultation processes. In addition, prior to December 1996, the Act allowed

the Minister to approve tariffs derived from a tendering process without setting requirements for the conduct of a tendering process.[26] This degree of discretion creates concerns as to regulatory accountability and transparency.

With these contexts in mind, the Council now turns to issues regarding regulatory processes for each of the s.58 pipelines.

Pipeline 2

The tariffs for pipeline 2 were originally approved by the Minister for Mines and Energy in 1996 and 1997 following regulatory processes conducted by QDME.

The Queensland Government informs the Council that it conducted public consultation as part of its consideration of the tariffs. The Council, however, notes the view of the ACCC that, for pipeline 2 (and for pipelines 24, 30 and 41):

> *The regulator (in this instance both the Queensland Government and the Commission) was unable to take account of informed market responses to proposed Reference Tariffs and in particular comments on the justification for cost allocation across customer classes from potentially affected parties (ACCC 2000, p.7).*

The Council is concerned that, while consultation took place, the regulatory process may not have given stakeholders sufficient opportunity to make informed comment.

Nor is it clear that public consultation had a significant bearing on tariff outcomes, as the approved average tariff appears to have been negotiated between the Government and AGL prior to the development of the access principles:

> *... the average tariff contained in the access principles was one that had been agreed in negotiations between the Government and AGL prior to the development of the draft principles, as part of the early negotiations with industry players on the south-west Queensland pipeline proposal (ACCC 2000, p.29).*

The basis for reaching the final approved outcome cannot be gleaned from Part 8 of the Petroleum Act, which allows the Minister considerable discretion over regulatory processes. The Council notes, however, that the approved tariffs were considered, on QDME's own analysis to yield a rate of return that was more likely to be "unreasonably high" than "unreasonably low" (reported in ACCC 2000, p.31).

[26] S.70A requires that the process be competitive, but this provision was inserted into the Act *after* access principles had been approved for pipelines 24 and 30.

On the evidence available, the Council has concerns that regulatory processes for pipeline 2 may have been flawed. In particular, a lack of detailed information would have made it difficult for parties to develop informed views, raising doubts as to the efficacy of the public process. In addition, the regulatory process lacked transparency, with the basis for approving the final tariffs apparently determined *prior* to the regulatory process.

Tendered pipelines

Reference tariffs for pipelines 24, 30 and 41 were set following tendering arrangements conducted by the Queensland Government and approved by the Queensland Minister.

Owners of the s.58 pipelines argue that the tendering processes were appropriate:

> *The fact that all tenderers were required to submit access principles prior to the successful tender for each pipeline being awarded and that there were several tenderers for each pipeline's tender process supports the view that the outcome of the tender process would ensure an efficient pricing (Duke, Epic, APT 2001, p.9-10).*

The Council considers that developing price guidance through a robust competitive tendering process can satisfy 6(4)(a)-(c) requirements. The very purpose of access regulation is to try to simulate competitive outcomes where a competitive market is missing. As such, the adoption of a soundly-based market process to achieve this end would reduce the need for a more regulator-intrusive process.

However, the effectiveness of this approach requires the tendering process to be genuinely competitive, with the selection criteria designed to deliver efficient price outcomes. For this reason, independent *ex ante* oversight of the tendering process is essential. This may also require a degree of *ex post* vetting to ensure that tendering outcomes are consistent with the approved process.

The owners of s.58 pipelines broadly agree with these general principles, but query the need for independent oversight:

> *A competitive tender process can be seen as an alternative to other processes because competition between parties is likely to lead to efficient pricing. In order to maximise the likelihood of this result, the tender process should be genuinely competitive and transparent. It may be desirable to have the process overseen by an independent party with no direct interest in the outcome of the process, but this is not of fundamental importance, nor is it a requirement of the CPA principles (Duke, Epic, APT 2001, p.9).*

The Council notes that a number of concerns have been raised as to whether the tendering processes for pipelines 24, 30 and 41 were appropriate. A significant concern is that the arrangements were conducted by the

Queensland Government and approved by the Queensland Minister. As the Council notes elsewhere, it is not confident that such a framework is sufficiently independent to guarantee outcomes that satisfy the balance of considerations listed in clause 6(4)(i). In particular, the Council has noted the potential for conflicts of interest to lead to inappropriate pricing outcomes.

An additional concern is that the some regulatory processes appear to have occurred without clear legislative underpinnings. In particular:

- The tendering processes for pipelines 24, 30 and 41 were completed *before* the Act gave explicit recognition to the use of competitive tendering to determine access principles: the s.70A provisions on competitive tendering were inserted into the Act in December 1996, while the tendering processes for pipelines 24, 30 and 41 were completed in December 1994 (pipelines 24 and 41), and April 1996 (pipeline 30); see Table 6 and Box 5.

- While final approval of access principles for pipelines 24 and 41 occurred under Part 8 of the Petroleum Act, the regulatory process was significantly progressed *before* the relevant regulatory provisions existed. In particular, the tendering processes, and an initial agreement on tariffs occurred prior to the commencement of Part 8 in July 1995.

- Part 8 provides no guidelines for the development and conduct of a competitive tendering process to determine access principles. While s.70A of the Act requires that a tendering process be competitive, this provision was inserted into the Act *after* access principles had been approved for pipelines 24 and 30.[27]

To some extent, regulatory processes appear to have occurred on an *ad hoc* basis. While this poses some difficulties in formulating a clear understanding of the regulatory processes that transpired, it also raises concerns of regulatory accountability and transparency.

The Council now turns to regulatory issues for each of the tendered pipelines.

Pipeline 30

The tender for pipeline 30 resulted in 33 expressions of interest, suggesting that the process was *prima facie* competitive. However, the regulatory process raises a number of concerns.

The Council has elsewhere noted a fundamental conflict in the tendering process, with the Queensland Government simultaneously selling the pipeline *and* conducting a tender to set tariffs. As such, the regulatory process was not

[27] While s.70A of the Act requires that the process be competitive, the Council understands that this provision took effect in December 1996. The tariffs for pipelines 24 and 30 were approved prior to this date.

exclusively designed to deliver pricing outcomes consistent with the clause 6 principles, but as a trade-off between maximising the sale price of the pipeline and achieving reasonable tariffs. The ACCC reported that the selection process favoured higher tariffs where demand was inelastic. The Council notes that tariff outcomes did not flow directly from the tendering process itself, but through negotiations between the vendor and the buyer that followed the tendering process. The Council also notes that access principles were approved by the Minister under Part 8 of the Act, which provides no guidance on the conduct of an appropriate tendering process.

Owners of the s.58 pipelines argue that the approach adopted by Queensland is not inconsistent with clause 6, as efficient pricing does not necessarily equate with the lowest possible tariffs:

> *... while the CPA principles require efficient pricing, they do not require the lowest possible tariffs (Duke, Epic, APT 2001, p.10).*

The Council notes that consultation with stakeholders was limited. In particular, there appears to have been no consultation with market participants on the tendering process. And while comments were sought on the proposed access principles, third party participation may have been hampered by the lack of detailed information made available.

Finally, while selection criteria were distributed to participants, it is not clear to the Council from the limited available evidence whether the Government chose the successful tenderer on the basis of those criteria.

On the evidence available, the Council has concerns that regulatory processes for pipeline 30 lacked independence and may not have been robustly competitive. In addition, the Council has concerns as to the openness and transparency of regulatory processes that followed the tendering process. While copies of the draft access principles were released to interested parties, the lack of detailed information available to stakeholders may have constrained their ability to make informed comment.

Pipelines 24 and 41

The Council notes that *prima facie*, the tendering process for these pipelines appears to have encouraged competitive bidding. The ACCC quotes a report from Bain and Co., a consultant to the Queensland Government, that the "benefits of the competitive process were evident in the bids."

However the tendering process raises a number of concerns. In particular, the Council has elsewhere noted its concerns that reference tariffs were approved by the Queensland Minister, who may have been open to a conflict of interest in filling this role.

In addition, the Council has noted that the tendering processes were completed, and an initial agreement was reached on access principles, prior to the commencement of Part 8 (or the s.70A tendering provisions) of the

Petroleum Act. In this sense, regulatory processes were significantly progressed in the absence of appropriate legislative provisions.

Regarding the conduct of regulatory processes, the Council notes that consultation with stakeholders was limited. At the outset, there was no consultation with parties on a proposed tender process. And while comments were sought on the proposed access principles, participation among third parties may have been hampered by the lack of detailed information made available. The ACCC stated that, for each of the s.58 pipelines:

> *The regulator (in this instance both the Queensland Government and the Commission) was unable to take account of informed market responses to proposed Reference Tariffs and in particular comments on the justification for cost allocation across customer classes from potentially affected parties (ACCC 2000, p.7).*

According to major pipeline companies, the process was sufficiently robust to generate competitive outcomes:

> *The fact that all tenderers were required to submit access principles prior to the successful tender for each pipeline being awarded and that there were several tenderers for each pipeline tender process, supports the view that the outcome of the tender process would ensure efficient pricing (draft, relates to all 3 tendered pipelines, p.11-12).*

The Council understands that the tendering process was not specified to stakeholders in advance. In particular, what began as a process to develop one pipeline was later transformed into a joint process for two pipelines. The ACCC reported that the selection process was developed and refined as it proceeded and that the Government made parties aware that it could vary the process at any time. As evidence of this fluidity, the Government sought comment from interested parties during shortlisting on the shortlisting process itself (this appears to be the only consultation that occurred on the tendering process).

Queensland argues that:

> *...it is not unreasonable to suggest that the flexible, market responsive approach adopted in this instance allowed outcomes to be achieved that were more efficient and innovative than would have been the case had a rigid, pre-determined set of arrangements been imposed (Qld Govt 2000b, p.3)*

Nonetheless, the Council is concerned that the process reflects a lack of clarity and transparency. These characteristics are also reflected in the fact that the selection criteria were not made available until shortlisting had occurred. Similar concerns relate to the final selection process. From the limited material available to the Council, the reasons for the Queensland Government selecting AGL ahead of other competing bidders for the CGP (pipeline 41) are not clear. Nor has the Council been able to ascertain how closely the approved tariffs for pipelines 24 and 41 correlate to the tariffs

proposed in the winning tenders. The Council does, however, note that Queensland stated, without providing specific details, that the agreed access principles reflected the tendered tariffs (Qld Govt 2002).

Third parties have reported serious concerns about the transparency and independence of the relevant tendering processes (submissions from Forcenergy, Chevron, Interstate Energy). According to Santos, one of the unsuccessful bidders:

> *...the selection process was not specified in advance and was not well understood, it clearly changed as the process itself changed over an 11 month period and in the end seemed quite arbitrary. There was no public consultation throughout the process and for the parties who missed short-listing and final selection, little explanation, if any, was given as to the reasons for their lack of success (quoted in ACCC 2000, section not publicly available due to confidentiality constraints).*[28]

Chevron, which was a potential user of the pipelines, raised similar concerns about the tendering process:

> *The process, which was used, lacked transparency and accountability. There was... no opportunity for public input into the selection process. The selection criteria used are not a matter of public record. Whether or not criteria were determined prior to bids being received, and whether or not they gave primacy to minimising the expected cost of transport to users generally over the life of the pipeline (as required by the Code) is similarly a matter for conjecture (Chevron submission, 1999).*

With regard to pipeline 24, Chevron states:

> *Users are unable to confirm that the reference tariffs and the reference tariff policy for this pipeline replicate the outcomes of a competitive market.... The government, in promoting the construction of this pipeline, was apparently concerned with security of supply issues (in the face of declining reserves and production from the Surat and Bowen Basin fields). It may also have been pursuing other objectives, such as promoting industry development opportunities...*

Chevron claims that similar issues arise for pipeline 41:

> *There was no opportunity for public input into the selection process. The selection criteria used are not a matter of public record. It is not known whether or not criteria were determined prior to bids being*

28 Santos also stated that: "*Notwithstanding the above history, the end result, with the SWQ Producers negotiating as a single user of the pipeline, resulted in an outcome that probably was not far removed from what would have occurred through an alternative process.*"

> *received, and whether or not the lowest expected cost of transport to users generally over the life of the pipeline was the main criterion...*
>
> *Users are unable to confirm that the reference tariffs and the reference tariff policy for this pipeline replicate the outcomes of a competitive market...*

Interstate Energy, commenting on all three tendered pipelines, wrote:

> *the methodology adopted to evaluate proposals was never made transparent to tender participants (Interstate Energy submission 1999).*

According to Forcenergy, a new entrant to the upstream sector:

> *The so called competitive tendering process conducted in Queensland was between pipeline developers and the Queensland Government. The rest of the industry was precluded from the process (Forcenergy submission 1999).*

An apparent irregularity in the tendering process is that new bids from a non-conforming party (Santos) were entertained after an original bid from that party failed to be short listed. This raises concerns as to the impartiality of the tendering process, and may have created uncertainty and confusion among the shortlisted parties.

Finally, the Council notes that selection criteria circulated in the final selection round focussed on the delivery of the lowest "packaged" delivered gas price. The Council notes that this would include the commodity cost of gas and potentially also the cost of transportation on another pipeline (or pipelines) to Brisbane. The ACCC argued that:

> *The focus on delivered cost of gas... does not provide the best framework to encourage tenderers to submit tariffs that are likely to be the lowest sustainable tariff (ACCC 2000, section not publicly available due to confidentiality constraints).*

The Council is concerned that use of 'packaged' pricing might encourage access providers to strike deals with gas producers, making transport tariffs less transparent. This may aggravate difficulties for third parties seeking to negotiate access to unbundled pipeline services.

Queensland disputes that the winning tender was chosen on the basis of lowest packaged gas price, and has informed the Council that the selection was based on lowest haulage tariff (Qld Govt. 2000b, p.4). It appears that the information provided to stakeholders was ambivalent on this matter, making provision for both approaches. The Council considers that this flexibility may have caused some confusion among stakeholders as to the actual selection criteria that would be applied, as well as concerns over the openness and transparency of the tendering process.

On the evidence available, the Council remains concerned that the tendering processes for pipelines 24 and 41 may not have been robustly competitive. While the tariffs proposed in the winning tender were subject to regulatory assessment, the Council has noted its concerns as to the independence of the Minister and QDME in this regard. And while copies of the draft access principles were released to interested parties, the lack of detailed information available to stakeholders constrained their ability to make informed comment. Once again, this raises questions as to the openness and transparency of regulatory processes, and casts doubt on the veracity of pricing quantums that flowed from those processes.

Conclusion

The Council is not satisfied that regulatory processes for pipelines 2, 24, 30 and 41 were sufficiently robust to provide reliable price guidance to access seekers. In particular, on the evidence available, the Council is concerned that:

- the tendering processes used to determine tariffs for pipelines 24, 30 and 41 were not robustly competitive;
- regulatory processes for pipelines 2, 24, 30 and 41 were deficient in terms of independence, openness and transparency; and
- for some pipelines, regulatory processes were significantly progressed prior to relevant legislative provisions being implemented.

The Council considers that these deficiencies in regulatory processes cast serious doubt on the reliability of price guidance that flowed from those processes. As such, the Council is concerned that the regulatory framework does not address information and market power asymmetry, and does not create an environment conducive to effective access negotiations. For these reasons, the Council is not satisfied that the regulatory framework is consistent with the requirements of clauses 6(4)(a)-(c).

Tariff outcomes

The Queensland Government argues that tariff outcomes are not relevant to considering the effectiveness of an access regime.

> *The clear words of the relevant clauses of the CPA do not imply a power to consider the processes or tariff outcomes of established pipelines (Qld Govt 2001, p.12).*

The Council considers that, in general, the clause 6 principles do not require an examination of pricing outcomes. The Council considers that a proper consideration of clauses 6(4)(a)-(c) must include an assessment of whether regulatory arrangements establish an environment in which third parties can enter effective access negotiations. In particular, the regulatory framework

should provide appropriate guidance to market participants to address information and market power asymmetries. In assessing these matters, the Council focuses on whether regulatory processes are robust.

For s.58 pipelines, the Council is not satisfied that the relevant regulatory processes were appropriate. Nonetheless, the Council did accept that if the outcomes from the regulatory process were within the range of outcomes considered appropriate, the Council's concerns about the regulatory process may be mitigated. This has been the Council's practice in the past in considering access regimes that have outcomes or reference tariffs embedded as part of the regulatory process (see for example, NCC 1999b and 2000d). On this basis, the Council considered that an assessment of outcomes would be useful and may have been of assistance to Queensland in its application. The Council considered an assessment of reference tariffs to be particularly central to an examination of outcomes given their importance to both access seekers and providers.

The Council notes that while the clause 6 principles do not specify pricing principles, they do provide some guidance as to appropriate pricing outcomes. In particular, clause 6(4)(i)[29] provides that terms and conditions should strike a balance between a range of factors including the legitimate business interests of the access provider, the interests of other parties, the delivery of cost-related pricing, the efficient use of infrastructure, and the public benefits arising from competitive markets.

In addition, the Council considers that the underlying objective of the 6(4)(a)-(c) model of commercial negotiation, supported by appropriate regulatory guidance, is to deliver outcomes that, as closely as possible, mirror outcomes that would be derived if the infrastructure service market was effectively competitive: that is, outcomes can generally be expected to lie within an efficient range.

The Council recognises, however, that in a workably competitive market, instances of transitory market power may arise resulting in outcomes that may not fall within what would be considered an efficient range. However, competitive pressures should ensure that outcomes ultimately fall within an efficient range. As noted by the Supreme Court (WA):

> *The expert evidence and writings tendered in evidence suggest that a workably competitive market may well tolerate a degree of market power, even over a prolonged period. The underlying theory and expectation of economists, however, is that with workable competition market forces will increase efficiency beyond that which could be*

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[29] The clause 6 principles are written from the perspective of a negotiate/arbitrate model. As such it envisages that clause 6(4)(i) be applied by an arbitrator. In many access regimes – including the Queensland Regime – responsibility for 6(4)(i) is at least partly shifted to the regulator.

achieved in a non-competitive market, although not necessarily achieving theoretically ideal efficiency (2002 at 128).”

Within the context of a workably competitive market, the Council would expect that effective access regimes would result in pricing outcomes that would ultimately fall within an efficient range and be structured towards eliminating opportunities for excessive profits, gold plating and inefficient operating practices. The Council has adopted these principles in evaluating price and costing parameters in a number of recent certification processes (see for example, NCC 1999b, 2000b, 2000d, 2001a).

The Council notes a general acceptance among stakeholders that the clause 6 principles point to efficient pricing outcomes. For example, the owners of s.58 pipelines give support to the concept of efficient pricing:

> *... while the CPA principles require efficient pricing, they do not require the lowest possible tariffs (Duke, Epic, APT 2001, p.10).*

The ACCC report

The Council considered that an assessment of outcomes may assist its consideration of Queensland’s application and in 1999, it engaged the ACCC as a consultant to advise on whether tendering processes and reference tariff outcomes for s.58 pipelines were appropriate. The Council requested the ACCC to test for broad consistency with the National Gas Code. This was because the National Gas Code had already been certified as effective by the Council and Queensland requested the Council to consider its regime as an application of the National Gas Code. As such, the ACCC’s benchmark for assessing the tariffs was recent regulatory decisions under the National Gas Code, for which the ACCC is the Australian gas transmission regulator. The benchmark therefore reflects the national regulator’s approach to appropriate pricing in the gas transmission sector.

There was considerable debate as to the appropriateness of the approach the ACCC was asked to take. In particular, Queensland and the owners of the s.58 pipelines argued that comparison of the derogations with the Code was not the correct test. Rather the derogations should have been assessed for compliance with the relevant CPA principles (See Qld Govt, 2001, p.12 and Duke, Epic, APT 2001, p.7). The Council considers that the Code, which had been found to be effective, was a sufficient but not necessary test of effectiveness under clause 6. The Council considers that effective access regimes, in terms of clause 6, are not required to adopt identical approaches or produce identical outcomes. But effective regimes should apply the common principles reflected in clause 6, including the principle of efficient infrastructure service pricing. As discussed above, while instances of transitory market power may arise in workably competitive markets, effective regimes can on the whole be expected to produce broadly similar outcomes. Consequently, the Council is able to regard the National Gas Code as a relevant broad indicator of the type of outcomes that an effective regime would be likely to produce.

In its report to the Council, the ACCC assessed whether tariff outcomes were appropriate by considering appropriate rates of return based on the financial circumstances and typical regulatory approach prevailing in 1996, and recent decisions of the ACCC as national gas regulator, adopting regulatory approaches in use in the year 2000. The Council notes that the Epic decision may have implications for regulatory decisions under the Gas Code. The ACCC report was prepared for the Council in light of jurisprudence applying prior to the Epic decision. The Council notes the concern of the pipeline owners that:

> *The conclusions in the ACCC's review of possible tariff outcomes under the Code will be erroneous if the review was based on the view that:*
>
> - *economic efficiency, with a focus on forward looking costs and events is a decisive or dominant consideration in assessing an access arrangement under the Code; or*
>
> - *the maximum value for the capital base is the DORC value of the pipeline (Sept 2002).*

The ACCC's principal findings on rates of return for s.58 pipelines (1996 and 2000 approaches) are summarised in Table 7. For a detailed evaluation, parties should refer to the original report (ACCC 2000).

Table 7 **ACCC findings on access tariffs**

Pipeline	Year	ACCC findings on ROE (return on equity)	ACCC findings on ROTFE (return on total funds employed)
2. Wallumbilla to Brisbane[30]	1996	significantly above reasonable expectations	significantly above reasonable expectations
	2000	significantly above reasonable expectations	significantly above reasonable expectations
24. Ballera to Wallumbilla	1996	reasonable	reasonable
	2000	reasonable	above recent determinations
30. Wallumbilla to Rockhampton via Gladstone	1996	reasonable	high end of reasonable
	2000	high end of reasonable	significantly above recent determination
41. Ballera to Mt Isa	1996	reasonable	reasonable
	2000	reasonable	above recent determinations

The ACCC reported that rates of return for pipeline 2 were "significantly above reasonable expectations" on all four indicators tested. The findings for pipelines 24 and 41 were, in the main, within a reasonable range, while the evidence for pipeline 30 was mixed.

The ACCC noted, however, that its investigation was constrained by limited access to information. In particular, pipeline owners declined to provide information on demand/volume projections and costs. The ACCC formulated its own estimates of these quantums, using, among other things, the tender bids and material provided by the Queensland Government. The ACCC reported deficiencies in the information it could draw on, and was unable to seek informed public comment because much of the available material was subject to commercial-in-confidence restrictions. This posed particular problems to the ACCC in assessing the reasonableness of cost allocations across various service classes. Normally, the ACCC relies heavily on comment from interested parties on this matter (ACCC 2000, pp.15-16). Given the constraints it was subject to, the Council considers that the ACCC estimates need to be interpreted and regarded with caution. The Council also notes the view of BHP Billiton, that the difficulties encountered by the ACCC in obtaining information is indicative of the "flawed regulatory processes for s.58 pipelines" (BHP Billiton, 2002).

The Queensland Government has disputed many aspects of the report, including the pricing outcomes:

[30] Stages 1 and 2 of the pipeline combined.

> *The Queensland Government considers there are... matters in the ACCC report which are not sound, being either based on inappropriate assumptions, incorrect interpretation or questionable analysis (Qld Govt 2000b, p.2).*

In particular, Queensland list a number of technical assumptions and “erroneous beliefs” embodied in the ACCC estimates for each pipeline that, it argues, makes the findings “unproven and irrelevant” (Qld Govt. 2000b, pp. 7-11).

As Queensland acknowledges, the discrepancies it alleges may be traced, at least in part, to the lack of “hard” information made available to the ACCC. In reference to pipeline 2, Queensland states:

> *The Commission stated that no information had been made available to it relating to costs, load factors or other assumptions, and it acknowledged that the evaluation had therefore been conducted relying on Commission estimates and assumptions. It is apparent that a number of these assumptions were incorrect and significantly impacted on the rate of return findings (Qld Govt 2000b, p.7).*

The Council notes that Epic Energy, in a confidential submission, has also questioned the accuracy of the ACCC analysis in relation to pipeline 24 (Epic Energy submission 2000).

The Council has not attempted to assess the claims made by Queensland and Epic Energy in regard to the ACCC’s analysis. The Council considers, however, that the manner in which the estimates were derived would suggest that caution should be exercised in interpreting the figures. The Council would be reluctant to rely on the estimates as a basis for assessing effectiveness under clauses 6(4)(a)-(c).

Notwithstanding its criticisms of the ACCC report, and its assertion that tariff outcomes are irrelevant to “effectiveness” under clause 6, the Queensland Government nonetheless draws on the report’s findings as evidence that the s.58 tariffs are appropriate:

> *The ACCC stated that the Return on Equity is its preferred measure/proxy for ‘reasonableness’. On this measure, the ACCC has said that the returns on three of the four pipelines fall within the reasonable range of returns. The returns on these three pipelines are comparable with a recent ACCC decision for a ‘greenfield’ gas pipeline (ie 15.4% post tax, nominal for the Central West pipeline). The length of the review periods are also comparable to periods adopted for other risky investments (Qld Govt 2001, p.5).*
>
> *...it can be argued on the merits the regime is effective in terms of the tariff outcomes. With the exception of the Roma to Brisbane pipeline, the tariffs (expressed in terms of a rate of return) have been assessed by the ACCC (on the measure that it regards as relevant in terms of “reasonableness”) to be within the reasonable range of outcomes. The*

> *tariffs are also comparable with recent regulatory decisions in relation to greenfield or risky investments. Two of the pipelines in question (ie. the Ballera to Wallumbilla pipeline and the Ballera to Mt Isa pipeline) were greenfields investments (Qld Govt 2001, p.21).*

The ACCC assessments of tariff outcomes appear to lend some credence to the Queensland Government's view that price guidance for pipelines 24 and 41 may not be inappropriate. The assessments also suggest that tariffs for pipeline 2 may be inefficient. The evidence for pipeline 30 is mixed.

However, the Council is reluctant to draw firm conclusions from the ACCC report for a number of reasons. First, the Council notes that the ACCC estimates were based on limited information, with no input from relevant pipeline companies and limited information from the Queensland Government. Second, the ACCC was unable to consult widely with stakeholders due to confidentiality concerns. Third, the Queensland Government has argued that the ACCC's investigation contains a number of errors, casting doubt on the accuracy of the reported outcomes. Fourth, both the Queensland Government and owners of the s.58 pipelines argue that the ACCC's findings are irrelevant because they are based on an assessment against the National Gas Code. Finally, the Supreme Court (WA) decision in the Epic decision may have implications as to the approach taken by the ACCC in its report.

With these cautions in mind, the Council is reluctant to form a definitive view, on the information available, as to whether reference tariffs for s.58 pipelines provide appropriate guidance to market participants. In order to make this position clear, the Council considered it appropriate to omit much of the discussion on the specific findings of the ACCC report noted in the February 2002 draft recommendation from this final recommendation.

Information disclosure

Given the Council's concerns as to the appropriateness of regulatory processes for s.58 pipelines, and the "softness" of evidence on pricing outcomes, the Council cannot be confident from the evidence available that the Queensland Regime provides appropriate price guidance. To help 'compensate' for deficiencies in the regulatory process on the provision of price guidance, an alternative would be for facility owners to release sufficient information on pricing and underpinning costings for third parties to make their own independent assessments.

The Council notes a requirement in the National Gas Code that gas pipeline owners release sufficient information for third parties to understand the derivation of reference tariffs: s.2.6. While this is not a requirement to satisfy clause 6, it does suggest that market power and information asymmetry can be a significant issue in the gas pipeline industry, and that information disclosure may be necessary to provide an appropriate basis for access negotiations to take place.

The s.58 derogations override this legislative requirement and exempt the owners of pipelines 2, 30 and 41 from providing information on the derivation of tariffs. Queensland has stated that a derogation on information disclosure is not available for pipeline 24 (Qld Govt 2000a, p.4).[31]

As the Council notes elsewhere, the ACCC has reported that information disclosure to interested parties was limited at the time the s.58 tariffs were originally approved by the Queensland Government. As such, the Government was not in a position to take account of informed market responses to proposed tariffs and, in particular, comments from potentially affected parties on cost allocations across customer classes.

The derogations on information disclosure have been the subject of considerable concern among market participants (see for example, Chevron submission 1999, Ergon Energy submission 1999; also ACCC 2002a, ACCC 2002b, Incitec 2001, Ergon Energy 2001, Energex 2001).

The ACCC considered that the "lack of detailed information to interested parties" could adversely affect the negotiation framework:

> *if this information is not released... access seekers may not be provided with sufficient information regarding the determination of reference tariffs to be able to negotiate acceptable tariffs without recourse to arbitration (ACCC 2000, p.7).*

Queensland argues that it is unnecessary to provide information on the derivation of access tariffs for three reasons:

1. For the tendered pipelines (pipelines 24, 30 and 41), tariffs were set through a competitive process, indicating that tariff outcomes should be appropriate. This makes it unnecessary to supply information on the derivation of tariffs (Qld Govt, 2000a, p.12).

2. Pipeline 2 has very little spare capacity, making access a hypothetical issue (Qld Govt, 2000a, p.13).

3. Access seekers can obtain sufficient information through the derogation statements, access arrangements approved by the regulator (covering non-price matters), and also through the regulator exercising their powers in arbitration (Qld Govt 2000a, p.12, 2000b, p.13).

The Council considers each of these arguments below.

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[31] The pipeline owner has indicated to the Council that despite the lack of an official derogation, the service provider does not intend to provide information on the derivation of access tariffs to the market. The ACCC's final decision on the pipeline in 2001 delayed a requirement to submit a complete access arrangement information package until 2004 – when some services covered by the access arrangement are scheduled for review (ACCC 2001, p.30).

Information not required for 'tendered' pipelines

On the first point, the Council concurs that if price guidance is determined through an independent and competitive process, it is reasonable to assume that price outcomes will be appropriate. In such circumstances, the Council agrees that the provision of detailed information on the derivation of access tariffs may not be necessary because third parties can be confident that prices offered are reasonable.

But as outlined elsewhere in this report, substantial doubts have been raised over the tendering and regulatory processes for pipelines 24, 30 and 41. As such, it cannot be assumed that tariff outcomes are reasonable. It is therefore appropriate that third parties be given access to sufficient information to make their own assessments.

The Council notes the ACCC findings that reference tariffs for pipelines 24 and 41 (and perhaps, pipeline 30) may lie within an appropriate range. The Council has considered whether this obviates the need to release detailed information. However the Council remains concerned that the ACCC findings are so qualified that they cannot necessarily be relied on.

Access to pipeline 2 is hypothetical

The Council is aware of capacity constraints on pipeline 2, but notes that the pipeline is subject to ongoing expansions. The Council understands that regulatory price guidance is not being offered on new tranches of capacity. The ACCC's current regulatory processes on this pipeline reveal continuing concern among stakeholders on this matter:

> *Many submissions indicated that the information disclosed by the RBP in their access arrangement information is insufficient to users and prospective users with respect to how the reference tariffs were initially derived and how negotiated services will be priced in the future (ACCC 2001, p. 9).*

Chevron, which was a potential user of pipeline 2, has stated that access seekers have:

> *no information available to confirm that the reference tariffs, or any tariffs and conditions which they might in future be offered for transportation on the Wallumbilla to Brisbane system, are cost reflective and competitive....(Chevron submission 1999).*

According to Incitec, a major gas user in Queensland:

> *Without adequate information disclosures and information on reference tariffs and reference tariff principles, gas users such as INCITEC, are unable to understand the derivation of their tariffs or assess that tariffs are fair and reasonable (Incitec 2001).*

Drawing on these concerns, the Council considers that information on the derivation of access tariffs would assist prospective users of pipeline 2 wishing to negotiate access to spare capacity that may arise in the future on new (or existing) tranches of capacity, and those parties wishing to negotiate a capacity expansion on the pipeline.

Information available from other sources

Regarding pricing information in the derogation statements, the ACCC reported that:

> *access seekers may not be provided with sufficient information regarding the determination of Reference Tariffs to be able to negotiate acceptable tariffs without recourse to arbitration (ACCC 2000, p.7).*

This concern is also reflected in submissions from parties such as Energex, Ergon Energy, Incitec and Chevron, referred to above.

Given the views of stakeholders and the ACCC, the Council cannot be satisfied that pricing information in the derogation statements is sufficient to allow access seekers to evaluate the fairness of the tariffs.

Nor does the Council regard arbitration – which is often costly and time consuming – as the appropriate forum for access seekers to obtain pricing information. In the Council's view, parties are likely to need pricing information *prior* to dispute resolution, to help assess whether it is appropriate to take their concerns to arbitration. In any case, the Council understands that the Queensland Regime locks an arbitrator into applying the reference tariffs approved by the Minister. This would appear to make arbitration a futile exercise to resolve pricing issues, except in the case of a non-reference service (see below).

Conclusion

For these reasons outlined above, the Council is not satisfied that access seekers have sufficient information to make a credible assessment of whether reference tariffs for pipelines 2, 30 and 41[32] are appropriate, and as such, may not have an adequate basis to engage in effective access negotiations.

Arbitration framework

In the preceding analysis, the Council noted that the veracity of price guidance for s.58 pipelines is open to considerable doubt. In addition, the regulatory framework does not enable third parties to obtain the necessary information to make their own assessments.

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[32] The Queensland Government has informed the Council that pipeline 24 is not covered by a derogation on the provision of information to third parties.

The remaining avenue for price testing normally available to third parties under an access regime is formal arbitration. However, this avenue is also precluded. The Queensland Regime requires an arbitrator to adhere to the Minister-approved reference tariffs in a dispute over pricing of reference services: s.6.13 of National Gas Code.

This framework poses issues under CPA clauses 6(4)(g) – a requirement for independent arbitration to resolve disputes – and 6(4)(i) – a requirement that the arbitrator-determined terms and conditions of access should take account of a list of specified matters. The Queensland Regime clearly prevents the arbitrator from making an independent decision on these matters.

The Council notes that such a framework is capable of being considered "effective" under clause 6, and similar provisions exist in the gas access regimes of other States and Territories. For other jurisdictions, the constraint did not raise certification issues as the "binding" reference tariffs had previously been assessed by an independent regulator, who was required to take account of the 6(4)(i) matters through open and transparent processes. In this sense, allowing the arbitrator to later re-open those tariffs could result in an inefficient duplication of robust processes and provide avenues for gaming behaviour.

The regulatory framework differs for s.58 pipelines. While the Petroleum Act required the Queensland Minister to take account of clause 6(4)(i) type matters (s.112(3)), the Council has reached a view in this assessment that the regulatory framework was deficient in terms of independence and transparency. Concerns have also been raised that regulatory processes for some of the pipelines may not have been directed towards pricing outcomes, as required under clause 6(4)(i). Finally, regulatory processes for pipelines 24 and 41 were significantly progressed prior to the commencement of s.112(3) of the Petroleum Act, raising doubts as to the extent to which clause 6(4)(i) matters could have been fully reflected.

The Council considers that binding the arbitrator to predetermined tariffs makes it essential that the 'locked in' tariffs were rigorously determined through independent and transparent regulatory processes designed to deliver the type of outcomes envisaged under clause 6(4)(i). The Council is concerned that the reference tariffs for s.58 pipelines do not appear, at any stage, to have been subject to open and transparent assessment by an independent body.

The Council is concerned that the lack of opportunity to test prices – either through independent regulation or dispute resolution – may discourage parties from attempting to negotiate access. The rights of third parties may appear so constrained that the prospect of negotiating a satisfactory outcome could seem futile. Nor is there sufficient incentive for service providers to negotiate away from the published prices, knowing that arbitration does not offer access seekers a forum to test prices. For these reasons, the Council considers that the model does not provide a viable basis for third parties to enter access negotiations.

The Council comments further on arbitration issues under clauses 6(4)(g)-(i).

Duration of s.58 arrangements

The foregoing analysis has led the Council to a view that regulatory arrangements for s.58 pipelines raise substantive issues under clauses 6(4)(a)-(c). An issue requiring separate consideration is the duration of the s.58 arrangements (see Table 8).

Table 8 **Duration of s.58 arrangements**

Pipeline	Review date (derogation terminates)
2 RBP	29 July 2006
24 SWQP	30 December 2016[33]
30 QGP	31 August 2016
41 CGP	1 May 2023

A number of parties have raised concerns with the Council that the duration of the s.58 arrangements is excessive (see for example, submissions from Envestra, Chevron, Transfield, Ergon Energy). The Council must consider whether this raises additional issues under clauses 6(4)(a)-(c).

Queensland argues that lengthy review periods are justifiable "in the context of facilitating infrastructure investment and development of a gas market" and argues that:

> *This concept was acknowledged by the Council of Australian Governments (COAG) in 1994 when it endorsed a report that stated that arrangements of longer duration were "essential to the development of the gas market, to enable the sharing of the risks of the very large investments required…*
>
> *It is contended that (the review periods for the pipelines)… are justifiable arrangements in the context of facilitating infrastructure investment and the development of a gas market (Qld Govt 2001, p.6).*

Many stakeholders disagree. According to Envestra:

> *Derogations were initially proposed as short term arrangements to provide for an orderly transition to the introduction of competition in the gas industry. Derogations such as those proposed by the Queensland Government are inconsistent with this objective and should not be approved by the NCC (Envestra submission 1999).*

[33] For AFT services (alternative form of transportation service to a full forward reference service), the review date is 11 June 2004.

Chevron has raised concerns that the duration of the s.58 arrangements may, over time, impede the development of competitive gas markets in Queensland:

> *Each of the (s.58) pipelines... could prove important to the Project Sponsors' plans to sell PNG gas widely throughout eastern Australia. Effective third party access to these facilities on competitive terms will be critical to the success of these plans. If as a result of the proposed derogations uncompetitive tariffs and inappropriate access principles are locked in for long periods, we believe that our own interests and those of gas pipeline users generally would be poorly served.*
>
> *The Project Sponsors therefore oppose the proposed derogations in relation to these pipelines. We believe that they could result in anti-competitive and inefficient arrangements being locked in to the Queensland gas transmission system. If this were to happen, it would have flow-on effects throughout the Eastern Australian gas market (Chevron submission 1999, pp.6-7).*

Santos raises similar concerns. With regard to pipeline 2, Santos wrote:

> *Santos is concerned with the costs of transportation in the RBP, and the long-term implications on growth rates for the gas industry in South East Queensland. Indeed the combined reference tariffs for the RBP and Epic pipelines to transport Cooper Basin gas to South East Queensland are more than twice the reference tariff for the Cooper Basin to Sydney pipeline, and three times the Moomba to Adelaide pipeline tariff. This makes Cooper Basin gas significantly less viable for Eastern Queensland customers compared to those of the Southern States. Competitive pipeline tariffs are important to assist market growth for gas in South East Queensland, which in turn supports further exploration and development of Queensland's gas reserves (Santos 2001a).*

Queensland noted that in balancing the need for infrastructure investment and appropriate access regulation, the concept of an "access holiday" or the need for longer regulatory review periods has been considered. In particular, Queensland notes the following view:

> *... Professor Stephen King of the University of Melbourne has ... suggested that "To avoid the disincentives for investment created by declaration, investors in new infrastructure facilities, should be allowed to apply for an 'access holiday'. In other words, investors should be allowed to present the ACCC with an undertaking such that the terms and conditions for access are that the infrastructure owner will not provide access for a fixed period of time, such as 20 years. The ACCC should be able to accept such undertakings when there is a reasonable high degree of uncertainty surrounding the investment, such that (say with a probability of at least 20%) the investment might fail" (Qld Govt 2001, p.12).*

The Council notes that the Queensland Regime purports to regulate pipelines and that the s.58 arrangements do not provide for an access holiday. This view is consistent with that of Queensland which, stated that it had never argued that the s.58 arrangements were either similar to or constituted an access holiday (Queensland Treasury, May 2002). In addition, the Council considers that there is no provision for access holidays under the clause 6 criteria. For these reasons, the Council has not considered whether the duration of the derogations constitute an appropriate access holiday.

The Council is concerned that the duration of s.58 arrangements may be inappropriate, given the Council's concerns as to deficiencies in the underlying regulatory processes. Locking in the s.58 tariffs for periods of up to 25 years could adversely affect the capacity of third parties to negotiate access for an unacceptable period of time.

Forecast error

The Council notes that the duration of s.58 arrangements would raise issues even if the "locked in" tariffs were derived from appropriate regulatory processes. In particular, regulatory processes can be subject to forecast error. Even tariffs that are efficient at the time they are assessed can become inefficient over time due to changes in demand, cost structures and technology.

Queensland argues that the durations of s.58 arrangements are appropriate:

> *It is contended that... (the review periods) are justifiable risk sharing arrangements in the context of facilitating the development of a gas market. The need for more secure arrangements in a developing gas market was acknowledged by the Council of Australian Governments (COAG) in 1994 when it endorsed a report that stated that arrangements of longer duration were "essential to the development of the gas market, to enable the sharing of the risks of the very large investment required …". For this reason, COAG decided to protect pre-existing arrangements and to allow a transition to the new regime. It is strongly contended that the pre-existing arrangements be considered in this light (Qld Govt 2001b, p.14).*

As guidance on an appropriate period to fix regulated tariffs, it may be useful to consider current legislative requirements in the Australian gas industry under the National Gas Code. Table 9 summarises the relevant information.

Table 9 National Gas Code: duration of approved tariff arrangements

Method of generating reference tariffs	Review arrangements
Regulatory approval of tariffs proposed by facility owner	no longer than 5 years unless independent regulator considers the need for mechanisms to address risk of forecast errors: s. 3.18.
Competitive tendering process subject to independent regulatory oversight	no longer than 15 years or later date approved by independent regulator; approved tender must include an appropriate policy to address forecast errors in volumes/revenues: s.3.28(d)(ii), 3.33(d), (e).

Source: National Gas Code

While current standards in the gas industry are not a test of effectiveness against clause 6, they do suggest that the characteristics of the industry warrant the inclusion of mechanisms (such as a revenue-sharing policy or trigger for review in the event of a material change of circumstances) to address forecast errors if arrangements are locked in for a long period of time.

The Council notes that regulatory processes for s.58 pipelines did not require an independent assessment of an appropriate review period. The ACCC reported that opportunities to review the regulatory arrangements are limited, although its concerns were qualified for pipelines 24 and 30.

The ACCC stated that the revenue sharing mechanism for pipeline 24 "significantly addresses" volume forecast risks for this pipeline.

For pipeline 30, the ACCC's concerns over the 20 year review period were "mitigated" by the inclusion in the access arrangement of a trigger to review the access principles if volumes exceed nominal capacity.

Below, the Council considers review arrangements for pipelines 2 and 41.

Review arrangements for pipeline 2

Pipeline 2 tariffs approved by the Minister in 1996 have been fixed without scope for review until 2006 – a duration of ten years. This compares with a cap in the National Gas Code of five years, unless an independent regulator considers the need for mechanisms to address the risk of forecast error: s. 3.18. The ACCC did not report an appropriate revenue sharing mechanism or review trigger for pipeline 2.

Stakeholders have raised the absence of a revenue sharing mechanism (or review event trigger) on this pipeline as a matter of concern.

According to Santos:

> *Santos understands that some overseas regulatory pipeline transmission models set a maximum revenue that a Service Provider can achieve in any year, based on a regulated rate of return of the asset. This may involve a process of returning revenue to shippers, if the total rate of return exceeds a prescribed limit set by the Regulator.*

This model is partially reflected in Duke and Epic's Access arrangements by way of tariff discounts (Duke) and Revenue Credits (Epic). There is no such provision in the RBP Access arrangements, which is a clear deficiency in the Service Provider's Access Arrangements.

The lack of a revenue sharing mechanism not only increases the already high rates of return, but may also encourage the Service Provider to act in such a way that inhibits the development of a competitive environment. Without any prescribed limits to the overall rate of return, additional revenue can be generated from "services" outside the regulated tariffs. These services could involve unreasonable commercial terms for any non regulated tariff request, or ... may involve deliberate strategies to limit the flexibility of existing firm customers in order to obtain additional revenue.

... the revenue sharing mechanism will also redirect sharing payments to existing shippers, if a new user obtains a lower unit cost capacity expansion. The revenue sharing mechanism would act as an automatic trigger to protect all shippers against unacceptably high transportation costs. Without such a trigger mechanism, South East Queensland gas consumers are exposed to an unacceptable level of risk to high transportation costs in the RBP (Santos 2001a).

Energex raises similar concerns:

The Access Arrangements propose no revenue sharing mechanism eg, in the event that substantial new capacity and or services are taken up, then none of the foundation shippers would see any reduction in their current tariff. The excess revenue would go straight to the pipeline owner – without regard for the significant (tens of millions) dollars ENERGEX (through Allgas) and the other foundation shippers have paid over the years. The lack of any limit on the rate of return for pipeline owners provides an open ended opportunity for additional non regulated revenues to be developed by the pipeline owners without any benefit flowing back through tariff structures (or other such means). Revenue sharing mechanisms are not new and have been proposed by many pipeline owners as a means of adjusting transportation cost in line with the revenue potential for the pipeline. ENERGEX believes that given the perceived rate of return noted for this pipeline it is believed that a revenue sharing policy would be an appropriate mechanism to compensate transportation pricing for the contracted users when above normal revenues are generated from the pipeline system (Energex 2001a).

Queensland states that the issue is academic, because spare capacity on the first 101 TJ/day capacity on the pipeline is fully contracted, and that market growth beyond that level would result in a new access arrangement:

There is no basis of any material concern in this regard, because there is no possibility of the market forecast being significantly exceeded.

> *This is because the pipeline system covered by the derogation is capped at a throughput of 101 TJ/day and, since this capacity is nearly fully contracted to 2006, any higher market growth would require establishment of a new access arrangement for the incremental capacity which is not covered by the derogation (Qld Govt 2000b, p.14).*

The Council notes that while use of the pipeline now exceeds 101 TJ/day, the scope of the s.58 derogations precludes a review of tariff arrangements and appears to preclude the regulator from requiring a reference tariff for the new tranches of capacity (ACCC 2002a). In this sense, the s.58 pricing arrangements appear to cover all tranches of capacity on the pipeline, including those that may come onstream in the future. A revenue sharing mechanism is not included for any tranche of capacity for the duration of the derogation.

Review arrangements for pipeline 41

Pipeline 41 tariffs approved by the Minister in 1997 have been fixed until 2023 – a duration of 25 years. The ACCC assessment for the Council did not report an appropriate revenue sharing mechanism or review trigger mechanism for pipeline 41.

Queensland disputes this finding:

> *Attachment 1 of the Access Principles specifies that for foundation shippers a tariff reduction applies once a threshold of 25 PJ/year is transported. The revenue sharing mechanism operates through a direct reduction in tariffs…*
>
> *Both BHP Mining at Cannington and Pasminco at Mt Isa are foundation customers… entitled to participate in the revenue sharing arrangement. MIM as the Principal foundation customer does not participate in the revenue sharing arrangement, but benefits from a tariff discount throughout the contract period. The mix of revenue sharing provisions and tariff discounts for the foundation shippers (whose commitments underpinned the pipeline development) reflects an acceptable sharing of the risks, from both a regulatory and commercially negotiated viewpoint, associated with different volume outcomes and revenue/cost consequences (Qld Govt 200b, p.16).*

The Council notes that the ACCC's 2001 final decision on an access arrangement for pipeline 41 states that:

> *The derogated tariff arrangement contains no provision for a profit-sharing mechanism and the Commission has no power under the*

derogation to require an amendment to the access arrangement to include such a mechanism (ACCC 2002b, p.12).[34]

The ACCC's recent regulatory processes on the pipeline have revealed considerable disquiet as to the duration of the review exemption on this pipeline. Among the parties to call for the specification of a major events trigger that would lead, if necessary, to an earlier review were BHP, CS Energy, MIM Holdings, Ergon Energy and Pasminco. CS Energy and the ACCC noted that future developments in the gas industry, such as the proposed Timor Sea or PNG to Northern Australia pipeline, could significantly alter the market environment for pipeline 41 over time (ACCC 2001 p.17, CS Energy 2001 p.11).

In this context, the Council cannot be confident that pipeline 41's foundation customer tariff reduction scheme materially address the volume/revenue risks that arise from a 25 year access arrangement period.

Conclusion

The Council is concerned that the duration of s.58 arrangements may be inappropriate, given the Council's concerns as to deficiencies in the underlying regulatory processes. Locking in the s.58 tariffs for periods of up to 25 years could adversely affect the capacity of third parties to negotiate access for an unacceptable period of time.

In addition, the Council is concerned that regulatory arrangements for pipelines 2 and 41 may not sufficiently address the risk of forecast error. The effect of this may, over time, be to set inappropriate tariffs that are difficult for third parties to negotiate away from, and which cannot be varied by an arbitrator.

The Council considers these outcomes to be inappropriate under clauses 6(4)(a)-(c).

Pipeline 2 capacity expansions

The Council notes that capacity expansions for pipeline 2 raise a number of specific concerns under clauses 6(4)(a)-(c).

In particular, the regulatory framework for pipeline 2 provides no price guidance (independent or otherwise) for capacity beyond 101 TJ/day.

[34] The ACCC required the inclusion in the access arrangement of major events that would trigger a review of non-tariff elements. The ACCC's power to do so was affirmed by the Australian Competition Tribunal in DEI Queensland Pipeline Pty Ltd v ACCC [2002] ACompT 2.

The Council notes that pipeline 2 has been subject to ongoing expansions, each subject to a separate set of access principles. In an access arrangement submitted to the ACCC in November 2000, the facility owner (Australian Pipeline Trust) lists the pipeline's capacity as 118.5 TJ/day. The ACCC recently reported a current capacity of up to 145 TJ/day (ACCC 2002a, p.vi).

While capacity up to 101 TJ/day is subject to s.58 of the QGPAA, regulatory arrangements for capacity above 101 TJ/day have been the subject of considerable confusion.

Interstate Pipeline Pty Ltd, at the time a part-owner of pipeline 2, informed the Council in 1999 that:

> *At present the RBP Joint Venture is negotiating with a number of prospective users for capacity beyond 101TJ/day. Such an expansion is being driven by market demand. In due course the RBP will expand the capacity and be required to put in place Access Principles for that capacity. These will clearly need to be based upon the National Code and reviewed by the relevant regulator, the ACCC.... (The) derogated reference tariffs do not alter the operation of the National Code nor do they restrict the ability of the Regulator to apply the National Code in respect of capacity above 101TJ/day immediately (Interstate Pipeline Pty Ltd submission 1999).*

Queensland reported in the year 2000 that:

> *... separate access arrangement(s) apply for volumes in excess of 101TJ/day which are outside the derogation (Qld Govt 2000b, p.6).*

In November 2000, APT and Interstate Pipelines Pty Ltd submitted an access arrangement on pipeline 2 to the ACCC for regulatory approval. The arrangement contains a reference service covering capacity up to 101 TJ/day, with a reference tariff determined under the s.58 derogation. The arrangement does not include a reference service or reference tariff for capacity above 101/TJ per day. The ACCC reported in its final decision on the access arrangement that it had sought legal advice on whether it could require reference tariffs for capacity above 101 TJ/day. It was advised that it could not do so (ACCC 2002a, p.8).

Consequently, it appears that capacity above 101 TJ/day remains within the scope of the s.58 derogation, but with no price guidance offered. Thus, the current regulatory framework applies one reference tariff to capacity up to 78.9 TJ/day, with a different tariff for capacity between 78.9 TJ/day and 101 TJ/day. The facility owner proposes that capacity beyond 101 TJ/day be treated as a series of 'negotiated services,' without reference tariffs.

The ACCC noted in its final decision on the access arrangement that:

> *The derogation relating to [the RBP] access arrangement explicitly releases APT from the obligation to provide access arrangement*

> *information in connection with the access arrangement under the reference service and reference tariff offered (ACCC 2002a, p.9).*

The ACCC cited the concerns of a number of stakeholders, including Ergon, CS Energy, Origin, Santos and Energex.

According to Ergon Energy:

> *APT's proposed Negotiated Service arrangement for... capacity between 101 TJ/day and 118.5 TJ/day does not provide any certainty for users because of the lack of regulated tariffs and could potentially impact upon the development of a competitive market. Given that the pipeline capacity above 101 TJ/Day will be utilised immediately, it is our view... that a regulated tariff should apply to the entire capacity to prevent monopoly power from being exercised (Ergon Energy 2001, p.4).*

Energex states:

> *ENERGEX believes that this is a fundamental deficiency in the proposed Access Arrangements as why should the pipeline owner be allowed to support effectively an unregulated tranche of capacity on the pipeline. How can any prospective user negotiate transportation rights with any certainty if there is no reference tariff as a starting point or supportive information to substantiate an alternative commercial position? (Energex 2001).*

The Council regards the absence of price guidance as a matter of concern. Its concerns are compounded by the fact that no information is made available to stakeholders on the derivation of reference tariffs for *any* tranche of capacity. In its final decision on APT's proposed access arrangement for pipeline 2, the ACCC reported:

> *Many submissions indicated that the information disclosed by the RBP in their access arrangement information is insufficient to users and prospective users with respect to how the reference tariffs were initially derived and how negotiated services will be priced in the future (ACCC 2002a, p.58).*

The ACCC also reported that it had no power to address the issue:

> *Given that the Commission is unable to require APT to provide additional reference tariffs beyond 101TJ/day and tariff-related information for reference tariffs, the Commission considered that obtaining access arrangement information relating to negotiated services would assist users in negotiating a reasonable tariff for that service. The Commission sought legal advice as to whether or not it could require APT to provide access arrangement information for negotiated services. The advice stated that the Commission is unable to require APT to provide this information, given the breadth of the*

> *derogation and that the bulk of the relevant information is tariff-related (ACCC 2002a, pp.58-9).*

In this sense, there is no guidance provided (independent or otherwise) for capacity above 101 TJ per day, and parties are not provided an opportunity to make their own assessments of appropriate tariffs.

The Queensland Government argues that arbitration under the National Gas Code arrangements is a suitable forum to address pricing issues for capacity above 101 TJ/day. But in its final decision on APT's proposed access arrangement for pipeline 2, the ACCC reported concerns among stakeholders that arbitration was an inappropriate mechanism in this case:

> *The Commission informed interested parties of the Queensland Government's view that arbitration is an adequate mechanism for gaining access to other services.*
>
> *However, interested parties responded that they did not believe that this is a viable course of action for a number of reasons, including:*
>
> - *the costs of going through an arbitration may exceed the benefits in terms of reduced tariffs; and*
> - *the potentially significant delays involved in a dispute resolution and arbitration may make it an unworkable option. For example, a new project may have a window of opportunity that will close well before an outcome might be expected from notifying a dispute. This is especially the case on this pipeline, where the Commission has not gone through the detailed process of assessing proposed reference tariffs. (ACCC 2002a, p.23).*

Santos argued that:

> *... while a dispute can be resolved through a formal process with the Regulator, this is not an attractive option for any potential user. That process creates additional costs, and may cause serious delays to a proposed project. Faced with this scenario, a user may have to accept unreasonable commercial terms to protect the viability of their project (Santos 2001a, p. 3).*

In considering this matter, the Council notes that arbitration can be an appropriate forum to resolve issues specific to the parties concerned – for example, a dispute over extension of a facility. Arbitration also has the advantage over more regulated approaches in that it is less intrusive upon property rights and less likely to deter new investment.

Nonetheless, the Council considers that arbitration is not an efficient mechanism for generating broad price guidance in industries characterised by information asymmetry and/or where many access disputes are likely. In particular, credible pricing structures may only emerge after a number of lengthy – and potentially costly – disputes have been resolved. For an issue

with a relatively small financial outcome pending, the matter is unlikely to be pursued through arbitration. In effect, it is likely to remain unchallenged, allowing the service provider to impose inefficient outcomes.

In this sense, an unregulated negotiate/arbitrate approach to pricing is unlikely to address information asymmetry and market power issues in the market for gas pipeline services.

The Council notes that capacity constraints on pipeline 2 , combined with the fact that demand can only be satisfied through capacity expansions, would suggest that the service provider has considerable market power. In this context, the need for independent price guidance to address market power and information asymmetry concerns is of particular importance. In the absence of such guidance, third parties are likely to face considerable difficulties in negotiating a reasonable tariff.

Apart from the Council's concerns as to the lack of appropriate price guidance, the Council notes the concurrent operation of multiple access arrangements for a single pipeline. The Council has been informed by the service provider that the total number of access arrangements for pipeline 2 could expand to six.

The Council is concerned that the existence of multiple access arrangements for a single pipeline may be a potential barrier to access for third parties. For example, is it unclear what set of arrangements an access seeker should seek to negotiate access under, and what set of arrangements would be relevant should spare capacity arise. Similarly, the right to independent arbitration on access prices applies to some tranches of capacity (tranches three and above), but not to others. Once again, it may be unclear whether a party has a right to seek arbitration, or is bound to a regulated tariff. Given these conditions, third parties face the prospect of entering access negotiations in a state of considerable confusion. The Council is concerned that the complexity and uncertainty associated with these arrangements may act as a deterrent to parties seeking access.

The Council's conclusion

Based on the foregoing analysis, the Council considers that, in regard to s.58 pipelines, the Queensland Regime raises substantial issues under clauses 6(4)(a)-(c).

3 Effect of s.59 derogation on negotiation framework

Under s.59 of the QGPAA, the Queensland Regime derogates, for a period, the access principles to apply to the proposed PNG-Queensland gas pipeline (PNG pipeline). Access principles for this pipeline are being developed through a competitive tendering process that commenced prior to the

National Gas Code being finalised. As such, regulatory processes have occurred outside the provisions of the National Gas Code. Instead, the pipeline has been subject to regulatory processes in the *Petroleum Act 1923.*

The Council understands that measures were taken to ensure that the tendering process for the PNG Pipeline was as consistent as possible with the competitive tendering provisions in the National Gas Code. In particular, consultative arrangements were established under which the ACCC must advise the Queensland Minister in relation to access principles for the PNG pipeline: s.44ZZM of the TPA.

The Council has previously recommended that the competitive tendering provisions of the National Gas Code are consistent with the clause 6 principles (NCC 1997 pp.24-5), noting that the provisions are especially suited to greenfields pipeline projects.

S.59 of the QGPAA provides that, should the ACCC advise the Queensland Minister to approve access principles for the PNG pipeline, those principles will be deemed to be approved under the National Gas Code. The Council understands that access principles approved under s.59 will apply for twenty years from the date of the first commercial gas deliveries through the pipeline. Subsequently, access principles will be subject to the regulatory processes of the National Gas Code.

For the s.59 derogation to apply, the proponents must submit access principles by 1 December 2002, and the Minister must approve the principles within twelve months of the principles being submitted. In the meantime, the pipeline remains subject to regulatory processes in the *Petroleum Act 1923.* Should the access principles not be approved within the designated timeframe, the PNG pipeline will remain covered under the National Gas Code (s.57), and an access arrangement must be submitted to the ACCC within 90 days for approval under that Code.

The service provider and the Queensland Government consulted at length with the Council during the development of the access approval process. The Council has indicated that should the ACCC advise the Queensland Minister that the tendering process and access principles are broadly consistent with the National Gas Code, the Council would consider that potential certification issues arising from s.59 are addressed. Should the ACCC advise the Minister *against* approving the access principles, the s.59 derogation would expire no later than 1 December 2003 and the National Gas Code provisions (previously found effective by the Council) would then apply.

The Council understands that the ACCC indicated to the Commonwealth and Queensland Ministers that the outcomes of the PNG pipeline tender process were reasonably consistent with the principles in the National Gas Code. More recently, however, there have been significant changes to the nature of the proposed project, and the ACCC's assessment has been delayed, pending additional information from the proponents.

The Council's view

Based on the foregoing analysis, the Council considers that, in regard to the proposed PNG pipeline, the Queensland Regime does not raise issues under clauses 6(4)(a)-(c).

4 Effect of contestability arrangements on negotiation framework

The Council notes that Queensland does not consider that the Queensland Regime includes a contestability timetable that phases in customer eligibility to choose their gas supplier. This differs from the Council's position that contestability timetables are an important part of jurisdictions' gas access arrangements. This is because to be effective, an access regime must adequately provide for access to all customers and not just to a distinct group of large customers.

The current contestability timetable in the Queensland Regime differs from that originally outlined in the implementation legislation, with access delayed for all customers by up to 18 months.

The initial and revised contestability timetables are set out in Table 10:

Table 10 Queensland Contestability Arrangements

	Initial	Revised
1 January 2000	$\geq$ 100 terajoules per annum	
1 July 2001		$\geq$ 100 terajoules per annum
1 September 2001	All customers	
1 January 2003		All customers

Queensland has informed the Council that the delay was necessitated by implementation issues that must be addressed in order to ensure fair and effective competition.

The Queensland Government provided the following update on contestability issues in November 2001:

> *On 1 July 2001, Queensland proceeded with contestability for customers with consumption greater than or equal to 100TJ per annum. In the Queensland gas market, these customers represent the bulk of the State's annual gas demand. The Office of Energy is currently developing market operating arrangements for these customers and the ACCC and QCA are in the process of assessing the access arrangements for transmission pipelines and distribution networks, respectively.*

> *The Government has amended the Gas Act 1965 to delay the introduction of contestability for customers below 100 TJ per annum from 1 September 2001 to 1 January 2003. The additional time will allow for the completion of an assessment of the costs and benefits of contestability to determine whether there is a net public benefit associated with this reform. The additional time will also permit the development of market operating arrangements and the resolution of other policy issues associated with the introduction of full retail contestability.*

The Council understands that phase-in arrangements may be necessary to allow parties sufficient time to make the transition from a sheltered market to a more competitive market. In the absence of an orderly transition, the technical systems, marketing arrangements and customer awareness of the workings of a competitive market may not be sufficiently developed to allow for effective access negotiations. In this sense, a phased-in transition can sometimes improve the overall effectiveness of the regime.

At the same time, the Council is aware that transitional arrangements impose delays on competitive arrangements, inhibiting the rights of parties to negotiate access. For this reason, the Council considers that while an effective access regime may incorporate transitional arrangements in response to public policy issues, the arrangements should be phased out as early as possible.

The Council concludes that there may be justifiable grounds for the amendment of Queensland's contestability timetable and that the delays may not be unreasonable.

The Council considers that the Queensland Regime does not satisfy clauses 6(4)(a)-(c).

Clause 6(4)(d)

Any right to negotiate access should include a date after which the right would lapse unless reviewed and subsequently extended; however, existing contractual rights and obligations should not be automatically revoked.

Background

Under clause 6(4)(d) an effective access regime should contain a mechanism to review, over time, the right to negotiate access to a service. Further, this process should not automatically revoke any existing contractual rights.

The Council considers that the intent of clause 6(4)(d) is to provide for a periodic review of the need for access regulation to apply to a particular service. For example, while a facility might not be economically feasible to duplicate at present (and warrant application of an access regime), market evolution and technological innovation might change this situation over time and remove the need for access regulation.

The Council considers that the review requirements in clause 6(4)(d) relate to the decision to apply an access regime to a particular service – that is, the coverage decision. In this sense, clause 6(4)(d) could be satisfied, for example, by way of a review provision on coverage decisions.

The Queensland Regime

The Queensland Regime allows any person to apply to the Council for coverage of a particular pipeline to be revoked. The Council then undertakes a public process to determine whether the pipeline satisfies the coverage criteria set out in the National Gas Code and makes a recommendation to the relevant Minister. The Minister (the Queensland Minister, for a distribution pipeline; and the Commonwealth Minister for a transmission pipeline) then makes a decision on the matter.

Both the Council's recommendation and the Minister's decision must be based strictly on the coverage provisions in the National Code. A decision to revoke coverage does not result in any existing contractual (or other) rights or obligations being automatically revoked.

The Queensland Regime embodies the coverage – and revocation of coverage – framework set out in the National Code. The Council recommended in September 1997 (with respect to the National Code) and in 1998 (with respect to the South Australian application of the National Code) that this framework satisfies clause 6(4)(d). The framework was certified as effective by the

Commonwealth Minister for Financial Services and Regulation with respect to the SA Gas Access Regime in December 1998.

The Council considers that the Queensland Regime satisfies clause 6(4)(d).

Clause 6(4)(e)

The owner of a facility that is used to provide a service should use all reasonable endeavours to accommodate the requirements of persons seeking access.

Background

The Council considers that an access regime may either incorporate this clause explicitly, or through general provisions that have the same effect.

The Queensland Regime

The Queensland Regime incorporates the provisions of the National Gas Code on this matter.[35] Under s.5 of the Code, the service provider of a covered pipeline must establish an information package containing, at least:

- the *access arrangement* and *access arrangement information* for the pipeline;
- a summary of the contents of the public register containing information on capacity;
- information relating to all major trunks and mains pipes comprised in the pipeline;
- a description of procedures relating to specific access requests (including the detailed information required to assess an access request); and
- any further information the regulator reasonably requires to be included to assist potential users to decide whether or not to seek access to services provided by covered pipelines or to determine how to go about seeking access to these services.

The service provider must provide the package within 14 days of receiving a request. The regulator may direct additional information to be included in the information package.

The National Gas Code requires that the *access arrangement information* for a pipeline include sufficient information to enable prospective users to understand the derivation of the elements in the access arrangement, including the reference tariffs – the relevant information includes access pricing principles, capital costs, system capacity and key performance indicators. The

35 This framework is modified for s.58 pipelines.

regulator must, if requested, consider whether an access arrangement information meets the requirements of ss.2.6 and 2.7 of the Code and may require that changes be made if appropriate.

Under s.3.2 of the Code, the services policy to be included in an access arrangement must, to the extent practicable and reasonable, enable a user to obtain only those elements that the user wishes to purchase at an unbundled price.

In addition, the Code provides that:

- a service provider must respond to a specific request for access within 30 days of its receipt: s.5.4;
- where the request for access can only be properly considered by the facility owner after further investigations, the owner must provide details of such investigations: s.5.5;
- if spare capacity does not exist, the owner must provide an explanation, including likely prospects for future access: s.5.6; and
- the service provider must establish a public register of capacity: s.5.10.

The Queensland Regime varies the provisions on information disclosure for some of the s.58 pipelines. In particular, service providers of pipelines 2, 30 and 41 are exempted from the requirement to provide an access arrangement information package to access seekers.

Issues and analysis

A threshold issue is to determine the scope of clause 6(4)(e), in the sense of what constitutes "reasonable endeavours" to accommodate the requirements of access seekers. In particular, the Council must consider whether inadequate requirements on information disclosure raises 6(4)(e) issues.

According to s.58 pipeline owners:

> *The principle in fact focuses upon the relationship between the asset owner and the potential user and commits the asset owner to using all reasonable endeavours to accommodate the requirements of those seeking access. The principle does not embody a narrow prescriptive obligation to disclose substantial financial or operational information (Duke, Epic, APT 2001, p.11).*

The Queensland Government considers that information disclosure is relevant to 6(4)(e), but that the scope of the clause is also considerably wider:

> *The NCC National Gas Access Regime, Assessment against the Competition Principles Agreement, September 1997 report argues that clause 6(4)(e) is principally about information disclosure. It is our*

submission that the scope of this clause is considerably wider, and that there are many means by which a service provider could evidence a willingness to try to accommodate the requirements of persons seeking access (Qld Govt 2000a, p.13).

When the Council assessed the National Gas Code in 1997, the most contentious issue raised under 6(4)(e) by stakeholders was the nature and extent of information disclosure that should be made to access seekers. The Council stated, in its assessment, that for the purposes of 6(4)(e):

...information disclosure must be sufficient to facilitate market assessments and fair and reasonable regulatory outcomes – especially given that the regulator approved reference tariffs cannot be reassessed in arbitration. At the same time, the information disclosure provisions should not be used as a device to unduly harm the service provider's competitive position in the market, which could undermine investment in gas infrastructure and potential access to spare capacity (NCC 1997, p.36).

The Council recommended in September 1997 that the National Gas Code achieves an appropriate balance with regard to information disclosure, and recommended that the Code satisfies 6(4)(e) in the context of the South Australian application of the Code. The framework was certified as effective by the Commonwealth Minister for Financial Services and Regulation with respect to the SA Gas Access Regime in December 1998.

As the Queensland Regime implements the National Gas Code provisions on information disclosure, the Council is satisfied that the regime, in general, satisfies clause 6(4)(e). However the standard Code provisions on information disclosure do not apply to three pipelines that are subject to s.58 derogations.

In particular, the s.58 arrangements for pipelines 2, 30 and 41 exempt facility owners from providing an access arrangement information package to third parties. In this sense, pipeline owners are not required to disclose information on the derivation of access tariffs to access seekers. Queensland has stated that a derogation on information disclosure is not available for pipeline 24 (Qld Govt 2000a, p.4). However, the owner of this pipeline has indicated to the Council that despite the lack of an official derogation, the service provider does not intend to provide information on the derivation of access tariffs to the market.[36]

The Council notes in its assessment against 6(4)(a)-(c) that, while the Queensland Regime provides price guidance (in the form of reference tariffs) for s.58 pipelines, the Council has concerns as to the appropriateness of the underlying regulatory processes and the "softness" of evidence on pricing

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36 The ACCC draft decision on the pipeline has delayed a requirement to submit an access arrangement information package until 2004 – when some services covered by the access arrangement are scheduled for review.

outcomes. Given these concerns, the Council cannot be confident that the Queensland Regime provides appropriate price guidance. In particular, the Council is not confident that regulatory processes were independent, open and transparent, and (in the case of the tendered pipelines) robustly competitive. These concerns are aggravated in that the regime does not allow access seekers to test reference tariffs through arbitration.

This framework makes it extremely difficult for third parties to judge whether reference tariffs are reasonable. A possible solution would be to allow access seekers to make their own independent assessment. For this to be possible, third parties would need access to reliable information on the derivation of prices.

The Council notes that it is a legislative requirement in the gas pipeline industry generally – under the National Gas Code – that service providers release sufficient information to third parties for them to understand the derivation of published reference tariffs.

While the National Gas Code is not the test for compliance with 6(4)(e), the nature and extent of information disclosure in the gas pipeline industry generally would suggest that a considerable degree of disclosure may be necessary to address market power and information asymmetry issues. The Council notes that the Code was developed through input from demand and supply sides of the industry as well as governments and regulators.

The derogations on information disclosure have been the subject of considerable concern among market participants (see for example, Chevron submission 1999, Ergon Energy submission 1999; also ACCC 2002a, ACCC 2002b, Incitec 2001, Ergon Energy 2001, Energex 2001).

Queensland argues that the provision of information on the derivation of prices is unnecessary (Qld Govt 2000a). The Council analyses Queensland's claims in its discussion of information disclosure under clauses 6(4)(a)-(c), and sets out its reasons for rejecting those claims.

The Council considers that deficiencies in the regulatory process for s.58 pipelines, combined with constraints on independent arbitration, make information disclosure on the derivation of tariffs a fundamental requirement of persons seeking access. The Council considers that, in not requiring facility owners to disclose such information for pipelines 2, 30 and 41, the Queensland Regime fails to satisfy clause 6(4)(e).

Pipeline 2 capacity expansions

The Council notes that capacity expansions for pipeline 2 raise a number of specific concerns under clause 6(4)(e).

The Council noted under clauses 6(4)(a)-(c) that the Queensland Regime provides no regulatory guidance (independent or otherwise) on tariffs for capacity beyond 101 TJ/day. Nor does the regime require the facility owner to

release pricing information that would allow third parties to make their own assessment. The Council considered that this could pose difficulties for parties seeking to negotiate access.

The Council also noted the existence of multiple access arrangements for pipeline 2 across different tranches of capacity, making it unclear what set of arrangements an access seeker should seek to negotiate access under, and what set of arrangements would be relevant should spare capacity arise. In this sense, it is not clear how a request for access would – or should – be treated.

According to Santos:

> *The Service Provider has proposed different tariff arrangements based on the following capacity tranches:*
>
> - *0 to 78.9 TJ/d*
> - *78.9 TJ/d to 101 TJ/d*
> - *101 TJ/d to 118.5 TJ/d*
> - *In excess of 118.5 TJ/d (latest proposal to the Queensland Government.)*
>
> *The Access Arrangements for all capacity tranches are different, and the third tranche arrangements proposed by the Service Provider are not covered by a Reference Tariff and are unknown. Each tranche contains a varied level of free flow capacity, compression capacity and looping capacity expansion. These complicated arrangements make it difficult for any user to assess whether any tariff is fair and reasonable. For existing shippers, it is also unclear how these shippers receive any benefits of lower unit cost capacity development and sharing of operating costs. Overall, this complicated model is likely to create opportunities for the Service Provider to enhance its returns (Santos 2001a).*

Incitec, a major gas user makes similar claims:

> *Whilst a negotiated service is proposed to be offered for capacity from 101TJ/day to 118.5TJ/day (but no reference service is to be offered), the proposed Access Arrangements do not provide information which enable users to understand how requests for access will be treated. The absence of information ... would also disadvantage potential users seeking negotiated services. These potential access seekers would be unable to negotiate acceptable tariffs without resource to arbitration, with all the attendant costs and delays involved (Incitec 2001, p.4)*

The Council is cognisant of the clause 6(4)(f) provision that access need not be on identical terms and conditions for all customers. However, the Council is concerned that the access framework for pipeline 2 may impose considerable

confusion on third parties, which may deter them from seeking access. The Council is concerned that such conditions may not be consistent with clause 6(4)(e). Rather than taking "all reasonable endeavours to accommodate the requirements of persons seeking access," the access framework for pipeline 2 may have the effect of confounding third parties.

The Council considers that the Queensland Regime does not satisfy clause 6(4)(e).

Clause 6(4)(f)

Access to a service for persons seeking access need not be on exactly the same terms and conditions.

Background

The Council considers that this clause removes any doubt that access *may* be provided on different terms and conditions to different users. Such an approach is consistent with the principles of commercial negotiation enshrined in clause 6.

The Queensland Regime

The Queensland Regime (consistent with the National Gas Code) requires pipeline owner/operators to submit an access arrangement which must include terms and conditions on which a service provider will supply each reference service. Parties may, however, negotiate terms and conditions outside those specified in the access arrangement. The Council understands that the regulatory framework for s.58 pipelines and the PNG-Queensland pipeline does not alter this framework.

Issues and analysis

The Council is satisfied that terms and conditions set out in access arrangements under the Queensland Regime do not limit scope for commercial negotiation. Rather, they act as a safety net where a reasonable outcome cannot be negotiated. The Council recommended in September 1997 (with respect to the National Gas Code) and in 1998 (with respect to the South Australian application of the Code) that this framework satisfies clause 6(4)(f). The framework was certified as effective by the Commonwealth Minister for Financial Services and Regulation with respect to the SA Gas Access Regime in December 1998.

The Council considers that the Queensland Regime satisfies clause 6(4)(f).

Clause 6(4)(g)

Where the owner and a person seeking access cannot agree on terms and conditions for access to the service, they should be required to appoint and fund an independent body to resolve the dispute, if they have not already done so.

Background

Under clause 6(4)(g), an effective access regime must contain a mechanism to ensure that the parties to a dispute have recourse to an independent dispute resolution process. The Council applies similar standards of independence to arbitration as it does to regulatory bodies (see analysis under clauses 6(4)(a)-(c)). In essence, the arbitrator should be independent of all stakeholders, including service providers, current users, access seekers and governments.

The Council's previous work in certification has raised an issue that the arbitrator's independence may be compromised if that body performs the dual role of regulator *and* arbitrator. For example, the issue may arise if a dispute arises over an access arrangement that the arbitrator has previously approved in its capacity as the regulator.

There are a number of ways to address this issue. In particular, the Council considers that the process of dispute resolution includes all mechanisms available for resolving disputes, including appeals processes. The Council views theses mechanisms as a package, with different elements capable of satisfying independence issues. Alternative approaches might include:

- separation of the regulator from the arbitrator (for example, by vesting each function in separate bodies); or
- a mechanism enabling either party to a dispute to require the arbitrator to appoint an alternative body if a question of bias arises; or
- an independent appeals process to address questions of arbitrator bias or independence.

The Queensland Regime

The Queensland Regime provides a number of mechanisms to resolve disputes arising prior to the signing of an access contract.

In particular, a party may refer a dispute over any aspect of access to the regulator, who may arbitrate on the matter: s.6 of the National Gas Code and Part 4 of the GPAL. In making a decision the arbitrator must apply the provisions of the access arrangement and take into account the matters set

out at s.6.15 of the Code. If the dispute is solely over the tariff to be applied to a reference service, the arbitrator must apply the reference tariff.

Procedures for the conduct of arbitration are set out at Part 4 of the GPAL. Arbitrations are to be conducted in private and are generally limited to the parties involved in a dispute. The allocation of costs is at the discretion of the arbitrator.

The arbitrator's decision is subject to appeal on a question of law: Part 4 of the GPAL. In addition, a decision is subject to judicial review: ss.20-21 of the QGPAA. The relevant judicial review bodies are:

- for decisions of the ACCC – the Federal Court, under the *Administrative Decisions (Judicial Review) Act 1977*.
- for decisions of the QCA – the Queensland Supreme Court, under the *Queensland Judicial Review Act 1991*.

While the arbitrator's decisions are not subject to administrative review, the regulator approved access arrangements on which many of these decisions are based, are reviewable in certain circumstances.

Once an access contract is signed, dispute resolution is a matter for the Courts (unless the contract provides for alternative mechanisms).

Issues and analysis

Arbitrator unable to rule on access prices

Clause 6(4)(g) requires that parties must have access to independent dispute resolution. A related provision is that, in making a decision, the arbitrator must apply the matters set out in clause 6(4)(i).

These entitlements are constrained under the Queensland Regime in that the arbitrator is *not* permitted to make an independent ruling on tariffs for reference services: s.6.13 of the National Gas Code. Instead, the arbitrator must apply reference tariffs previously established through regulatory processes.

Prima facie, s.6.13 raise significant issues under clause 6(4)(g) in that it constrains an arbitrator from ruling on what may be the most contentious issue between the parties – the price of access services.

The Council considers that the restriction must be considered in the context of the overall design of the Queensland Regime. In particular, the regime generally requires[37] that the reference tariffs (to which the arbitrator is

[37] This framework is modified for s.58 pipelines. See below.

bound) must be approved by an independent regulator through a series of open and transparent processes, must take account of a list of matters that closely reflect CPA clause 6(4)(i), and must be consistent with efficient pricing principles. Alternatively, reference tariffs may be determined through a robust competitive tendering process vetted by an independent regulator.

In considering the National Gas Code, the Council was guided by the views expressed by industry participants – both on the demand and supply side – that the arbitrator should adhere to the reference tariffs approved by the regulator. It was argued that this would create a higher degree of certainty for all parties, and would reduce the risk of gaming, delays and costly arbitration. It was further argued that this would avoid the need to duplicate the thorough processes of the regulator, and would promote a more stable environment for investment (NCC 1997, pp.28-9).

With these considerations in mind, the Council accepted that setting fair and reasonable reference tariffs which remain binding on an arbitrator may promote commercial negotiation by removing the prospect of costly and time consuming arbitration and uncertainty over terms and conditions.

The Council emphasised, however, that regulatory processes must be robust if they generate outcomes that bind the arbitrator. If the regulator makes an inappropriate decision, there is no opportunity to address the issue through dispute resolution. A biased decision could result in inefficient prices, inefficient use of infrastructure (perhaps inefficient duplication) and lost opportunities to advance the public benefit through competition. To address these issues, the Council stated that:

> *...the independence (from service providers, access seekers and governments) and appropriate resourcing of the regulator are crucial (NCC 1997, p.29).*

The Council noted that the National Gas Code incorporates:

- extensive public consultation on the approval of access arrangements by an independent regulator;
- a merits appeal mechanism on the regulator's decision; and
- the requirement for periodic review of access arrangements.

The Council was satisfied that these safeguards provided appropriate checks and balances to ensure that the resulting reference tariffs are robust enough to justify being exempt from further scrutiny by an arbitrator.

The Council concludes that while the Queensland Regime imposes constraints on the application of 6(4)(g), such constraints are not unreasonable in the context of the regulatory design of the Queensland Regime as a whole.

S.58 pipelines

The regulatory framework outlined above is modified for s.58 pipelines. While the Petroleum Act requires Ministerial approval of access principles, requires the Minister to take account of clause 6(4)(i) type matters (s.112(3)), and equips the Minister with information gathering powers, the Council reached a view in its assessment under 6(4)(a)-(c) that the regulatory framework may be deficient in terms of independence and transparency. The Council is also concerned that the tendering processes used to generate some tariffs appear not to have been robustly competitive. Finally, regulatory processes for some pipelines appear to have significantly progressed prior to the commencement of s.112(3) of the Petroleum Act, raising some doubt as to the extent to which clause 6(4)(i) matters could have been fully reflected.

The Council considers that binding the arbitrator to predetermined tariffs makes it essential that the 'locked in' tariffs were rigorously determined through appropriate regulatory processes. Given the Council's concerns over the processes used to determine reference tariffs for s.58 pipelines, the Council cannot be confident that the tariffs are appropriate. Consequently, the Council does not consider it appropriate for the arbitrator to be bound by the tariffs.

The Council's concerns are exacerbated by the duration of the s.58 arrangements, with reference tariffs for some pipelines not open for review for up to 25 years. In this sense, the arbitrator may be bound for up to 25 years to apply a reference tariff determined through regulatory processes that may have been inappropriate.

Given these concerns, the Council considers that it would not be appropriate to prevent the arbitrator from examining – and, if necessary, varying – reference tariffs for s.58 pipelines. For this reason, the Council considers that the Queensland Regime unreasonably constrains independent dispute resolution and that the regime does not satisfy clause 6(4)(g).

Independence of the arbitrator from the regulator

Under the Queensland Regime, the Queensland Competition Authority (**QCA**) has the dual role of regulator and arbitrator for distribution pipelines, while the ACCC undertakes this dual role for transmission pipelines. Each body, as regulator, considers and approves access arrangements for particular gas pipelines; while in an arbitration capacity, they hear disputes arising under regulator-approved access arrangements.

Concerns were raised during the Council's consideration of the National Gas Code that, if a body acts both as regulator and arbitrator, it is open to a conflict of interest if called on to arbitrate with respect to an access arrangement it previously approved as the regulator. This raised an issue under clause 6(4)(g), as to whether the regulator could undertake its arbitration functions in a truly independent manner.

Queensland's certification application stated that, in accord with s.11 of the 1997 Gas Agreement, Queensland would ensure that the QCA develops guidelines (including practices and procedure notes) to ensure that its arbitration functions are carried out independently of its regulatory functions under the Queensland Regime.

The QCA published guidelines for the conduct of arbitration hearings in October 1999. These guidelines were amended in November 2001 to strengthen provisions relevant to a potential conflict of interest between regulatory and arbitration roles.

In particular, the November 2001 guidelines require that should either of the parties to a dispute so request, the Chairperson will ensure that the membership of the arbitration hearing is independent of those members who had been substantially involved in decision making relevant to the issue under arbitration: clause 3.2.1.

The guidelines also include wider provisions on independence, including a requirement that members disclose a potential conflict of interest, and not participate in an arbitration if they have a potential conflict of interest: clause 3.2.5.

The Council is satisfied that the QCA guidelines address issues relating to the independence of the arbitrator from the regulator.

The Council understands that the ACCC is preparing arbitration guidelines setting out its approach to arbitration of disputes involving gas transmission pipelines covered by the National Gas Code. These guidelines are expected to address the need for clear separation between arbitration and regulation roles.

The Council considers that the Queensland Regime does not satisfy clause 6(4)(g).

Clause 6(4)(h)

The decisions of the dispute resolution body should bind the parties; however, rights of appeal under existing legislative provisions should be preserved.

Background

An effective access regime should have credible enforcement arrangements to ensure an arbitrator's decision is binding. In addition, the regime should preserve existing legislative rights of appeal. This does not require the insertion of new appeals provisions. However, a regime may offend this clause if it precludes a right of appeal under judicial review (for example, on account of breaches of the rules of procedural fairness).

The Queensland Regime

In accord with the National Gas Code, a decision made by an arbitrator under the Queensland Regime takes effect 14 days after the decision is made. The owner/operator of the pipeline is bound by the arbitrator's decision under s.6 of the Code. The access seeker is also bound by the decision unless they notify the arbitrator within 14 days of the decision being made that they do not intend to be bound.

Decisions made by the arbitrator are enforceable under Part 5 of the GPAL. The regulator or any other person may bring civil proceedings seeking compliance with the outcome of a dispute resolution process under the Queensland Regime.

Appeals provisions under the Queensland Regime are noted in the Council's discussion of clause 6(4)(g).

Issues and analysis

In its first round of public consultation, the Council sought views on whether the Queensland Regime affects any appeal rights that may exist under existing access legislation. The Queensland Government had informed the Council that the *Petroleum Act 1923* contains appeal mechanisms through the *Commonwealth Administrative Decisions (Judicial Review) Act*. Queensland indicated that these appeal mechanisms would be removed under recent review of the Act, and replaced by the appeal provisions in the National Gas Code.

No concerns regarding these changes have been raised with the Council.

In general, the Queensland Regime embodies the arbitration and appeals framework set out in the National Gas Code. The Council recommended in September 1997 (with respect to the National Gas Code) and in 1998 (with respect to the South Australian application of the Code) that this framework satisfies clause 6(4)(h). The framework was certified as effective by the Commonwealth Minister for Financial Services and Regulation with respect to the SA Gas Access Regime in December 1998.

The Council considers that the Queensland Regime satisfies clause 6(4)(h).

Clause 6(4)(i)

In deciding on the terms and conditions for access, the dispute resolution body should take into account:

(i) the owner's legitimate business interests and investment in the facility;

(ii) the costs to the owner of providing access, including any costs of extending the facility but not costs associated with losses arising from increased competition in upstream or downstream markets;

(iii) the economic value to the owner of any additional investment that the person seeking access or the owner has agreed to undertake;

(iv) the interests of all persons holding contracts for use of the facility;

(v) firm and binding contractual obligations of the owner or other persons (or both) already using the facility;

(vi) the operational and technical requirements necessary for the safe and reliable operation of the facility;

(vii) the economically efficient operation of the facility; and

(viii) the benefit to the public from having competitive markets.

Background

An effective access regime should require a dispute resolution body to take account of each matter set out in clause 6(4)(i) of the CPA. An effective access regime may also require a dispute resolution body to take account of other matters which are not inconsistent with those in this clause.

The Queensland Regime

The Queensland Regime applies the National Gas Code framework with regard to clause 6(4)(i). In hearing a dispute, the regulator must apply the provisions of the access arrangement, and take account of the matters listed in s.6.15 of the National Code – which closely reflect clause 6(4)(i). However, in a dispute over the price of a reference service, the regulator is bound to apply the reference tariff.

Issues and analysis

Under the Queensland Regime, the arbitrator is not permitted to make an independent ruling on reference tariffs for reference services: s.6.13 of the National Gas Code. Instead, the arbitrator must apply reference tariffs previously established through regulatory processes.

Prima facie, s.6.13 raises significant issues under clause 6(4)(i) in that it constrains an arbitrator from making an independent ruling on the price of a reference service. In this sense, the arbitrator's ability to apply the 6(4)(i) matters is severely constrained. The Council notes that clause 6(4)(i) also applies to matters other than price. However, the only constraint imposed on the arbitrator under the Queensland Regime that raises concerns under clause 6(4)(i) is in relation to reference tariffs. All other rules guiding the arbitrator under the regime reflect relevant provisions from the National Gas Code, which has been approved as effective by the Council. This point was highlighted by the owners of the pipeline in a joint submission (Epic, Duke, APT, 2002, p.10)..

The Council considers that a restriction such as this needs to be considered in the context of the overall design of an access regime. A restriction on determinations by the arbitrator may be acceptable if the matters binding the arbitrator have previously been assessed against 6(4)(i) through independent and robust regulatory processes. The Council notes that the Queensland Regime generally requires such an assessment.[38] An independent regulator must, through independent and transparent processes, take account of a list of factors that closely mirrors 6(4)(i) when deciding whether to approve proposed reference tariffs: s.2.24 of the National Gas Code. This means that the 6(4)(i) matters are already appropriately reflected in the reference tariffs that bind the arbitrator, and as such, will also be reflected in the arbitrator's decision.

The Council notes that, as an alternative to regulator-assessed tariffs, the Queensland Regime allows the proponent of a new facility to have reference tariffs determined through a competitive tendering process to select the infrastructure operator: ss.3.21-3.36 of the National Gas Code. Under this approach, parties bid to become the access provider by specifying the price at which they are willing to supply the access service.

An issue for the Council is that the competitive tendering provisions do not require an explicit application of 6(4)(i) – yet they remain binding on the arbitrator. The question therefore arises: how is 6(4)(i) applied in the case of a competitively tendered pipeline?

The Council notes that the Queensland Regime's competitive tendering provisions require an independent regulator to determine a number of

38 This framework is modified for s.58 pipelines. See below.

considerations including that the tender process is in the public interest; will deliver efficient cost-reflective prices; will be competitive; and will deliver fair and reasonable cost allocations between users. In addition, the very nature of a tendering process will ensure that the owner's legitimate business interests are reflected. The Council regards each of these considerations as being closely reflected in 6(4)(i) – in particular, clauses 6(4)(i)(i), (ii), (vii) and (viii).[39] The Council accepts that this framework will result in relevant 6(4)(i) matters being appropriately taken into account in the regulatory framework.

The Council concludes that while the Queensland Regime imposes constraints on the application of clause 6(4)(i), such constraints are not unreasonable in the context of the regulatory design of the Queensland Regime as a whole.

The Council notes, however, that the regulatory framework is modified for s.58 pipelines, which may affect the way clause 6(4)(i) is applied to those pipelines. Below, the Council considers the application of 6(4)(i) to each of the s.58 pipelines.

Pipeline 2

Reference tariffs for pipeline 2 were approved under the *Petroleum Act 1923* by the Queensland Minister for Mines and Energy. The tariffs were not subject to a tendering process. As part of the regulatory process, the Minister was required to take account of the matters set out at s.112(3) of the Act. The Council considers that the s.112(3) provisions take reasonable account of the 6(4)(i) matters. However, the Council is concerned that the regulatory process for assessing the s.112(3) matters may not have been appropriate.

The Council sets out elsewhere its reasons for not considering a Government Minister or department to be appropriately independent for the purposes of access regulation (see discussion under clauses 6(4)(a)-(c)). In particular, the Council considers that clause 6(4)(i) requires a carefully balanced assessment of a number of often-conflicting matters. To deliver outcomes acceptable to all parties, the 6(4)(i) matters need to be weighed and judged by a body without vested interests in a particular outcome. The Council is concerned that a Government Minister may be open to interests that conflict with the balance of considerations reflected under clause 6(4)(i).

The Council is also concerned that regulatory processes on pipeline 2 lacked openness and transparency. While QDME conducted public consultation on proposed access principles, it appears that stakeholders were not given

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[39] The Council notes that Queensland Regime's competitive tendering provisions relate only to *proposed* pipelines that have not been built. Some 6(4)(i) matters will not be relevant in these circumstances; for example matters relating to the interests of current users and parties holding contracts – subclauses (iv) and (v). In addition, some 6(4)(i) matters relate to issues other than access pricing; for example, facility extensions and safety issues – subclauses (iii) and (vi). The Queensland Regime does not constrain the arbitrator on these matters.

sufficient information to make informed comment. In addition, the regulatory process lacked transparency, with the basis for approving the final tariffs not readily apparent. The Council notes the ACCC's finding that public consultation may not have had a significant bearing on final outcomes, as the approved average tariff appears to have been negotiated between the Government and AGL during negotiations on the SWQP in 1994 (ACCC 2000, p.29). These negotiations predate s.112(3), which commenced in July 1995. This timing calls into question the extent to which s.112(3) could have been applied.

On the evidence available, the Council cannot be satisfied that regulatory processes for pipeline 2 provided a robust and independent assessment against clause 6(4)(i). For this reason, the Council considers that binding the arbitrator to the outcomes of those regulatory processes raises significant issues under clause 6(4)(i).

Pipelines 24, 30 and 41

Reference tariffs for pipelines 24, 30 and 41 were approved under the *Petroleum Act 1923* by the Queensland Minister for Mines and Energy. Approval followed tendering processes to select the operator of each pipeline. Queensland has informed the Council that as part of the regulatory process, the Minister assessed the tariffs against s.112(3) of the Petroleum Act.

The Council accepts that the s.112 provisions are a reasonable reflection of clause 6(4)(i), but has similar concerns to those noted in relation to pipeline 2. In particular, the Council has elsewhere set out its views that the regulatory framework for these pipelines lacked independence (see discussion under clauses 6(4)(a)-(c)).

The Council noted, for example, the potential conflicts open to the Queensland Minister in applying clause 6(4)(i) to pipeline 30. In this instance, the successful bidder was chosen on the basis of a trade-off between maximising sale price of the pipeline and achieving reasonable tariffs. It may have been difficult for the Minister to independently assess the tariffs against clause 6(4)(i), while being aware of the government's conflicting objective of maximising the sale price of the pipeline. The Council also noted potential conflicts with regard to pipelines 24 and 41.

The Council was also concerned that the tendering processes used to generate the tariffs do not appear to have been robustly competitive, and that the regulatory processes which followed were lacking in transparency. Finally, regulatory processes for pipelines 24 and 41 were significantly progressed prior to the commencement of s.112(3) of the Petroleum Act, raising some doubt as to the extent to which the s.112(3) matters could have been fully reflected.

On the evidence available, the Council cannot be satisfied that regulatory processes for pipelines 24, 30 and 41 provided a robust and independent assessment against clause 6(4)(i). For this reason, the Council considers that

binding the arbitrator to the outcomes of those regulatory processes raises significant issues under clause 6(4)(i).

The Council considers that the Queensland Regime does not satisfy clause 6(4)(i).

Clause 6(4)(j)

The owner may be required to extend, or to permit extension of, the facility that is used to provide a service if necessary but this would be subject to:

(i) such extension being technically and economically feasible and consistent with the safe and reliable operation of the facility;

(ii) the owner's legitimate business interests in the facility being protected; and

(iii) the terms of access for the third party taking into account the costs borne by the parties for the extension and the economic benefits to the parties resulting from the extension.

Background

In some situations, the needs of an access seeker can only be met by extending the geographical range of a facility or by expanding the capacity of a facility.

These are matters which, in the first instance, should be subject to negotiation between the parties. But clause 6(4)(j) requires that the arbitrator be empowered to require an extension, to address the situation where agreement cannot be reached. The arbitrator may exercise this power subject to:

- an extension being technically and economically feasible, and consistent with the safe and reliable operation of the facility;
- the owner's legitimate business interests in the facility being protected; and
- access tariffs being adjusted, if necessary, to reflect the costs and benefits of the extension to the parties.

The Queensland Regime

The Queensland Regime applies section 6.22 of the National Gas Code, which states that the arbitrator may require the owner/operator of a covered pipeline to expand its capacity to meet the requirements of an access seeker, provided that:

- the owner/operator is not required to extend the geographical range of a covered pipeline;

- the expansion is technically and economically feasible and consistent with the safe and reliable provision of the service;
- the owner/operator's legitimate business interests are protected;
- the access seeker does not become the owner of a covered pipeline or part of a covered pipeline without the agreement of the owner/operator; and
- the owner/operator is not required to fund part or all of the expansion (except where the extensions/expansions policy in the access arrangement for covered pipelines states that the owner/operator will fund the new facility and the conditions specified in the extensions/expansions policy have been met).

The Queensland Regime incorporates the National Gas Code's definition of 'services' which includes 'the right to interconnect' with a covered pipeline.' As such, an access seeker can invoke the dispute resolution process contained in section 6 of the Code and Part 4 of the GPAL in the event of a dispute over terms and conditions for interconnection with a covered pipeline.

Issues and analysis

In its assessment of the National Gas Code, the Council noted that it may often be efficient to provide for *interconnection* to a pipeline (and allow the access seeker to construct an extension), rather than to require the service provider to construct an extension. For this to be feasible, an access regime must empower the arbitrator to require interconnection if the 6(4)(j) conditions are met. The National Gas Code has adopted this approach.

The Council also noted that while the wording of 6(4)(j) refers only to extensions, an efficient way of increasing the supply of a service may be for the existing provider to *expand capacity*, rather than requiring the access seeker (or someone else) to construct another facility to provide a service. This is especially true of facilities where it is efficient to expand capacity incrementally, such as gas pipelines and rail track. For this reason, it would be appropriate to also apply the 6(4)(j) principles to expansions. The National Gas Code has also adopted this approach.

The Council is satisfied that under the Queensland Regime, the arbitrator may require capacity expansion of a pipeline and/or interconnection permission. The Council previously endorsed that this framework satisfies 6(4)(j) in its assessment of the National Gas Code and the South Australian Regime.

In the first round of consultation, the Council sought information from interested parties as to whether s.58 of the QGPAA raises issues under 6(4)(j). No issues were raised in this regard.

Expansion of pipeline 2

The Council notes that capacity expansions have particular relevance to pipeline 2, which has been subject to capacity constraints for several years.

The Council notes that the ACCC's final decision on the proposed access arrangement for pipeline 2 raised a number of concerns among stakeholders regarding the expansions policy for this pipeline (ACCC 2002a). The Council considers these concerns to be relevant to its assessment under clauses 6(4)(a)-(c), and addresses the issues there.

The Council is not aware that the regulatory framework for pipeline 2 constrains the application of clause 6(4)(j), with regard to the arbitrator hearing a dispute over a capacity expansion. In particular, s.58 of the QGPAA does not explicitly limit the application of s.6.22 of the National Gas Code. In this sense, there appear to be nothing in s.58 that prevents a party from notifying a dispute to the ACCC regarding a capacity issue. Nor does the ACCC appear to be constrained in its approach to resolving the dispute.

The Council considers that the Queensland Regime satisfies clause 6(4)(j).

Clause 6(4)(k)

If there has been a material change in circumstances, the parties should be able to apply for a revocation or modification of the access arrangement which was made at the conclusion of the dispute resolution process.

Background

The Council believes that this clause should be considered in conjunction with clause 6(4)(a), which places an emphasis on commercial negotiation. The parties could define for themselves, during the course of commercial negotiations, what the threshold is for a 'material change in circumstances' and may insert in the contract those events that would trigger a reopening of negotiations.

Alternatively, an access regime could make provision for parties to refer disputes concerning what constitutes a material change in circumstances to the dispute resolution body or some other independent body.

The Queensland Regime

The Queensland Regime does not specifically allow a party to seek revocation or modification of a contract or arrangement due to a material change in circumstances. However, parties may determine in advance what constitutes a material change in circumstances in drawing up contracts/arrangements for access. Further, where parties cannot agree on terms in this regard, the issue may be referred to dispute resolution.

The Queensland Regime does not preclude the application of common law principles (such as the doctrine of frustration) to matters of this nature once access contracts have been entered into.

The Queensland Regime applies the principles of the National Gas Code with regard to this matter. The Council recommended in September 1997 (with respect to the National Code) and in 1998 (with respect to the SA Regime) that this framework satisfies clause 6(4)(k).

The Council considers that the Queensland Regime satisfies clause 6(4)(k).

Clause 6(4)(l)

The dispute resolution body should only impede the existing right of a person to use a facility where the dispute resolution body has considered whether there is a case for compensation of that person and, if appropriate, determined such compensation.

Background

This clause does not require an access regime to allow a dispute resolution body to impede existing rights. However where a dispute resolution body can do this, it must be empowered to consider and, if appropriate, determine compensation.

The Queensland Regime

Section 6.18 of the National Code provides that the regulator must not make a decision that would impede the existing right of a user to obtain services; or would deprive any person of a contractual right that existed prior to the notification of the dispute, other than an 'exclusivity right' which arose on or after 30 March 1995.[40]

Issues and analysis

In the Council's assessment of the National Gas Code and the South Australian Gas Access Regime, it concluded that:

- as the arbitrator is unable to impede an existing contractual right (other than an exclusivity right arising on or after 30 March 1995), there is no need for the arbitrator to consider compensation; and
- the existing right of a person to use a facility is unlikely to be impeded by the regulator – in the sense that the regulator's decision relates to terms and conditions of access to spare capacity in a pipeline. The potential to impede a party's contractual right to use a facility would be more likely to arise from subsequent decisions through arbitration – except that the Code prohibits this under section 6.18.

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[40] An exclusivity right is defined in the Code as a contractual right that by its terms either: expressly prevents a service provider supplying services to persons who are not parties to the contract; or expressly places a limitation on the service provider's ability to supply services to persons who are not parties to the contract.

The Council subsequently assessed the National Gas Code as consistent with clause 6(4)(l). The Queensland Regime calls up the National Gas Code in this regard, and is therefore consistent with clause 6(4)(l).

The Council considers that the Queensland Regime satisfies clause 6(4)(l).

Clause 6(4)(m)

The owner or user of a service shall not engage in conduct for the purpose of hindering access to that service by another person.

Background

The Council believes that an access regime may incorporate this clause explicitly or contain general provisions which have the same effect.

The Queensland Regime

The Queensland Regime applies Part 3 of the GPAL to address hindering issues. Part 3 is designed to ensure that:

- the owner/operator of the covered pipeline;
- a person who is party to an agreement with the owner/operator with respect to the service provided by the covered pipeline;
- a person who, as a result of an arbitration decision, is entitled to a service provided by the covered pipeline; or
- an associate of the owner/operator of a covered pipeline or a person (as referred above) does not prevent or hinder access to a service provided by a covered pipeline.

Part 3 also notes that hindering access need not be the only reason for the action; only that it is a substantial purpose.

Under the Queensland Regime, the QCA – as local regulator – may apply to the Supreme Court of Queensland seeking a pecuniary penalty in the event that a breach of the preventing/hindering access provisions is established for a distribution pipeline. Similarly, the ACCC may apply to the Federal Court should it identify a situation where access is being prevented or hindered for a transmission pipeline.

The Council recommended in September 1997 (with respect to the National Code) and in 1998 (with respect to the SA Regime) that this framework satisfies clause 6(4)(m).

The Council considers that the Queensland Regime satisfies clause 6(4)(m).

Clause 6(4)(n)

Separate accounting arrangements should be required for the elements of a business which are covered by the access regime.

Background

This clause is designed to ensure the availability of financial information exclusively covering the elements of a business subject to an access arrangement.

The Queensland Regime

The Queensland Regime applies section 4 of the National Code in providing for ring fencing arrangements. Queensland notes in its certification application that, as a minimum, an owner/operator must:

- not carry on a related business within six months of the pipeline becoming covered;
- establish and maintain a separate set of accounts for each activity that is the subject of an access arrangement;
- establish and maintain a separate consolidated set of accounts in respect of all activities undertaken by the owner/operator; and
- allocate any costs that are shared between a ring fenced activity and any other activity according to a methodology that is well accepted, fair and reasonable.

In addition, the regulator may require the service provider to meet additional ring fencing requirements or waive any of the minimum obligations. Under both situations, the regulator must comply with the procedures set out in section 4, including consideration of public submissions before making a decision to add or waive ring fencing obligations. A decision by the regulator to impose additional ring fencing obligations or waive minimum ring fencing obligations is subject to review by the appeals body.

Issues and Analysis

The Council found in its assessment of the National Gas Code that, taken as a whole, the ring fencing provisions in the Code address the requirements of clause 6(4)(n) in a rigorous manner – but that this may be appropriate given the degree of vertical integration in the gas industry.

The Council subsequently assessed that the National Gas Code is consistent with clause 6(4)(n).

The Council considers that the Queensland Regime satisfies clause 6(4)(n).

Clause 6(4)(o)

The dispute resolution body, or relevant authority where provided for under specific legislation, should have access to financial statements and other accounting information pertaining to a service.

Background

An effective access regime should provide the dispute resolution body and other relevant bodies (for example, regulators and appeals bodies) with the right to inspect all financial documents pertaining to the service.

The Queensland Regime

Part 7 of the GPAL confers on the regulator the power to require any person to provide it with information or documents which the regulator has reason to believe will assist it in carrying out certain functions under the Queensland Regime. The regulator can also specify the form the information or documents should be provided in.

Under Part 4 of the GPAL the arbitrator is able to:

- gather information about any matter relevant to the access dispute in any way the arbitrator thinks appropriate;
- require evidence or argument to be presented in writing, and may decide the matters on which it will hear oral evidence or argument; and
- summons a person to appear before it to give evidence and to produce such documents as are referred to in the summons.

Part 7 and Part 4 also contain provisions relating to handling confidential information for the regulator and arbitrator respectively.

Failure to comply (without a lawful excuse) with the requirements of the regulator or the arbitrator in this context can attract a fine or imprisonment.

Issues and analysis

The approach set out in the Queensland Regime incorporates that of the National Gas Code. The Council recommended in September 1997 (with respect to the National Code) and in 1998 (with respect to the SA Regime) that this framework satisfies clause 6(4)(o).

In the first round of consultation, the Council sought information from interested parties as to whether s.58 of the QGPAA raises issues under clause 6(4)(o). No issues were raised in this regard.

The Council notes that s.58 absolves service providers from submitting an access arrangement information to the regulator in relation to reference tariffs. However, the Council understands that s.58 does not override the regulator's or arbitrator's information gathering powers established under Parts 4 and 7 of the GPAL.

The Council notes that the regulator is not permitted to make a determination on reference tariffs for reference services; nor is the arbitrator permitted to make an independent ruling on prices for reference services. In this sense, the information gathering powers appear to have limited relevance to the pricing of reference services. However, the arbitrator can use the Code's information gathering provisions in a pricing dispute over a non-reference service, or a dispute over non-price terms and conditions.

The Council considers that the Queensland Regime satisfies clause 6(4)(o).

Clause 6(2)

The regime to be established by Commonwealth legislation is not intended to cover a service provided by means of a facility where the State or Territory Party in whose jurisdiction the facility is situated has in place an access regime which covers the facility and conforms to the principles set out in this clause unless:

(a) the Council determines that the regime is ineffective having regard to the influence of the facility beyond the jurisdictional boundary of the State or Territory; or

(b) substantial difficulties arise from the facility being situated in more than one jurisdiction.

Clause 6(4)(p)

Where more than one State or Territory access regime applies to a service, those regimes should be consistent and, by means of vested jurisdiction or other co-operative legislative scheme, provide for a single process for persons to seek access to the service, a single body to resolve disputes about any aspect of access and a single forum for enforcement of access arrangements.

Background

Clauses 6(2) and 6(4)(p) relate to the services of facilities extending beyond the boundary of the State or Territory seeking certification. Clause 6(2) suggests that a State or Territory access regime might be found to be ineffective due to:

- its influence beyond the jurisdictional boundary of the State or Territory; or
- substantial difficulties arising because the infrastructure subject to the regime crosses a State or Territory border.

Clause 6(4)(p) provides that where a service is subject to access regimes in more than one State or Territory, those regimes should be consistent and should provide for a single process, a single dispute resolution body and a single enforcement forum. To satisfy this clause, the relevant State or Territory access regimes could contain provisions to facilitate a seamless and consistent approach to access the service.

The Queensland Regime

The Queensland Regime includes a number of processes to streamline regulation of cross-border pipelines. They are:

- an access regime with virtually identical effect is being implemented in all States and Territories.
- the ACCC is the single national regulator for all transmission pipelines, including those which cross borders. The administrative appeal body in relation to decisions of the ACCC is the Australian Competition Tribunal.
- for distribution pipelines that cross borders, the regulator and appeals body are determined by which jurisdiction has the 'closest connection' with the facility. The relevant bodies are those specified in the legislation of that jurisdiction: Part 3 of GPAL.
- the National Gas Code includes a single process for coverage of all cross-border pipelines. For a transmission pipeline, the decision maker is the designated Commonwealth Minister. For a distribution pipeline, the relevant Minister is determined under the 'closest connection' test.
- the Queensland Regime incorporates a national process for determining whether a covered pipeline is classified as a transmission or distribution pipeline, and thus, who is the relevant regulator: Part 3 of GPAL.

Ss. 14, 16 and 55 of the QGPAA give effect to cross-vesting arrangements in Queensland.

Cross border pipelines in Queensland

The Queensland Regime covers at least one cross-border pipeline: the proposed Papua New Guinea to Queensland pipeline, which would pass through Papua New Guinea, Commonwealth waters and mainland Queensland.

The Council understands that, while the pipeline is subject to the legislation of several jurisdictions (PNG National, PNG provincial, Commonwealth of Australia and Queensland), a single access arrangement covering all of the Australian section of the pipeline (from the PNG-Australia border to south Queensland) is being developed under Queensland's access legislation.

The Queensland application notes that while the Moomba – Sydney pipeline passes through south-west Queensland, the entire pipeline is listed in Schedule A of the National Code as being covered in NSW. That is, regulation of the entire pipeline is vested in NSW.

Issues and analysis

In its September 1997 assessment, the Council found the National Gas Code to be consistent with clauses 6(4)(p) and 6(2) but noted that it would reconsider this in the context of each jurisdiction's certification application (NCC 1997, p.55).

The Council notes that the underpinning framework of the Queensland Regime establishes a single regulatory process (including enforcement of access arrangements and dispute resolution) for access to cross-border services. In particular, a single regulatory process applies to cross-border transmission pipelines, while cross-vesting provisions ensure that a single, unambiguous regulatory process applies to the services of a cross-border distribution pipeline.

Interstate effect of derogated s.58 arrangements

The QGPAA establishes derogations that quarantine s.58 pipelines (pipelines 2, 24, 30 and 41) from having to comply with tariff-related aspects of the National Gas Code, including:

- regulatory processes for setting reference tariffs;
- reference tariff principles;
- regulatory review arrangements; and
- provision of information to third parties on the derivation of reference tariffs (an issue for pipelines 2, 30 and 41 only).

The Council is obliged to consider whether the derogations pose issues under clause 6(2)(a). For example, issues could arise if the s.58 arrangements have an adverse influence beyond the Queensland border.

Chevron, which was a potential user of s.58 pipelines, argues that national consistency in gas pipeline regulatory arrangements is an important consideration, and that:

> *Inconsistencies across State boundaries will create distortions that will tend to hamper market development and prejudice future investment in and growth of the industry (Chevron submission 1999).*

While the Council takes such claims seriously, it would regard complete consistency of a State access regime with wider national arrangements as a high hurdle for clause 6(2). But the Council is cognisant that significant issues would arise, for example, if the Queensland Regime generated inefficient terms and conditions that imposed a barrier to interstate trade in gas, or posed an impediment to interstate interconnection with the Queensland pipeline grid.

The issue is, to some degree, hypothetical, as no interstate pipeline currently interconnects with the Queensland transmission system.[41] But the situation may change over time, with one proposal to ship gas from Papua New Guinea to Queensland, and others to ship gas from the Timor Sea to Northern Australia. Over time, these infrastructure proposals may have a significant bearing on competition in Australian gas markets. The issue takes on relevance given that the s.58 arrangements have a duration of up to 25 years.

Chevron, which was a promoter of the PNG-Queensland pipeline, and prospective user of the wider Queensland gas transmission pipeline network, argued in a submission to the Council that the Queensland derogations could have an adverse effect on investment decisions. Chevron argued that the access arrangements for s.58 pipelines contain significant inconsistencies from the National Gas Code implemented in other States and Territories, and that the s.58 pipelines:

> *could prove important to the Project Sponsors' plans to sell PNG gas widely throughout eastern Australia. Effective third party access to these facilities on competitive terms will be critical to the success of these plans. If as a result of the proposed derogations uncompetitive tariffs and inappropriate access principles are locked in for long periods, we believe that our own interests and those of gas pipeline users generally would be poorly served (Chevron submission 1999).*

In this respect, the company cites a number of concerns and irregularities regarding the tendering processes for pipelines 24, 30 and 41, concluding that third parties have no basis for being confident that reference tariffs are competitive and cost-reflective (the Council examines these concerns under clauses 6(4)(a)-(c)). For pipeline 2, Chevron stated that the derogation absolving the service provider from supplying financial information to access seekers means that Chevron, as a potential user, has:

> *no information available to confirm that the reference tariffs, or any tariffs and conditions which they might in future be offered for transportation on the Wallumbilla to Brisbane system, are cost reflective and competitive.... (Chevron submission 1999).*

Chevron concluded:

> *The Project Sponsors therefore oppose the proposed derogations in relation to these pipelines. We believe that they could result in anti-competitive and inefficient arrangements being locked in to the Queensland gas transmission system. If this were to happen, it would have flow-on effects throughout the Eastern Australian gas market (Chevron submission 1999).*

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[41] Notwithstanding that a section of the Moomba to Sydney pipeline is located in Queensland.

The Council notes that while Chevron's concerns related to its proposed PNG-Queensland pipeline, the issues raised may also be relevant to other interstate or international gas infrastructure proposals, including the possible construction of pipelines from the Timor Sea.

This consideration was reflected in the ACCC's recent regulatory processes on pipeline 41 (which is subject to a s.58 derogation). These processes revealed considerable disquiet as to the duration of the review exemption on this pipeline. Among the parties to call for the specification of a major events trigger that would lead, if necessary, to an earlier review were BHP, CS Energy, MIM Holdings, Ergon Energy and Pasminco. CS Energy and the ACCC noted that future developments in the gas industry, such as the proposed Timor Sea or PNG to Northern Australia pipelines, could significantly alter the market environment for pipeline 41 over time (ACCC 2002b p.17, CS Energy 2001 p.11).

The Council considers that the extent to which clause 6(2) issues arise may depend on investor perceptions of the appropriateness of access terms and conditions for the derogated pipelines. In this context, it may be relevant to reiterate concerns raised by Santos:

> *...the combined reference tariffs for the RBP and Epic pipelines to transport Cooper Basin gas to South East Queensland are more than twice the reference tariff for the Cooper Basin to Sydney pipeline, and three times the Moomba to Adelaide pipeline tariff. This makes Cooper Basin gas significantly less viable for Eastern Queensland customers compared to those of the Southern States. Competitive pipeline tariffs are important to assist market growth for gas in South East Queensland, which in turn supports further exploration and development of Queensland's gas reserves (Santos 2001a).*

In contrast, Queensland argues that:

> *The existence of two serious proposals for interconnection [ie. PNG and Timor Sea pipelines] suggests the existing reference tariffs arrangements are not impeding interstate trade or interconnection (Queensland Treasury, 2002).*

The Council has not separately assessed the appropriateness of s.58 tariffs (see discussion under clauses 6(4)(a)-(c)), but has noted elsewhere in this report that the access framework for these pipelines raises significant issues.

In particular, the Council has noted:

- deficiencies in the regulatory processes for s.58 pipelines: see clauses 6(4)(a)-(c);
- inadequate requirements on the release of financial information to assist access seekers in evaluating access tariffs: (6(4)(a)-(c) and (e);
- inappropriate constraints on the arbitrator (6(4)(a)-(c),(g) and (i).

Given the fundamental nature of these issues, the Council has some concerns that these aspects of the regime may pose a disincentive to interstate trade and interstate interconnection with transmission pipelines in Queensland. The fact that the derogated arrangements are in place for up to 25 years suggests that such disincentives may become significant over time.

For these reasons, the Council is concerned that s.58 arrangements may raises clause 6(2) issues.

The Council considers that the Queensland Regime may raise issues under clause 6(2).

The Council considers that the Queensland Regime satisfies clause 6(4)(p).

5 Duration of Certification

Background

Under section 44M(5) of the TPA, when the Council recommends that the Commonwealth Minister make a decision on the effectiveness of a State or Territory access regime, the Council must also recommend the period for which any certification should be in force.

In recommending a certification period the Council must balance the need to establish the certainty necessary for infrastructure investment with the need to ensure that changes in technology or market structures do not make the regime obsolete or inappropriate.

The Queensland Regime

Queensland seeks a recommendation from the Council that its access regime be certified as effective for a minimum of 15 years.

Issues and analysis

The Council has previously recommended that applications of the National Gas Code in Victoria, New South Wales, Western Australia, South Australia the ACT and the Northern Territory be certified for a period of 15 years.

In making its recommendations, the Council took account of the views of the applicant governments and other interested parties. The Council considered that 15 years represented an appropriate balance of factors, including:

- the need among stakeholders for regulatory certainty, especially in the development of new infrastructure; and
- the likely impact of changes in technology and market structures on the relevance and appropriateness of the regime over time.

The Council notes that submissions did not raise concerns as to the proposed duration of certification of the Queensland regime.

However, given that the Council is unable, at this stage, to recommend that the Queensland Regime satisfies the clause 6 principles, it is unable to recommend a duration of certification.

Final Recommendation

The Council considers that the Queensland Regime, in its current form, does not satisfy the clause 6 principles. The Council therefore considers it unnecessary to recommend a duration of certification.

Public submissions

Submissions to the Council as part of public consultation on the Queensland Regime in 1999

1. Duke Energy, April 1999.
2. AGL, May 1999.
3. Chevron, May 1999.
4. Envestra, May 1999.
5. Epic Energy, May 1999.
6. Ergon Energy, May 1999.
7. Forcenergy, May 1999.
8. Interstate Energy, May 1999.
9. Transfield, May 1999.
10. Williams Gas Pipeline International, May 1999.

Submissions to the Council during consultation with the Queensland Government and pipeline companies in 2000 and 2001

1. Epic Energy, September 2000.
2. Australian Pipeline Trust, September 2000.
3. Queensland Government, November 2000.
4. Australian Pipeline Trust, Duke Energy and Epic Energy joint submission, November 2001.

Submissions to the Council as part of public consultation on the Queensland Regime in 2002

1. Australian Pipeline Trust, Duke Energy and Epic Energy joint submission, May 2002.
2. BHP Billiton Petroleum, May 2002.
3. Energex, May 2002.

4. Origin energy, May 2002.

5. Queensland Major Gas Users Group, May 2002.

6. Queensland Treasury, May 2002.

7. Australian Pipeline Trust, Duke Energy and Epic Energy joint submission, June 2002.

8. Australian Pipeline Trust, Duke Energy and Epic Energy joint submission, September 2002.

9. Origin energy, September 2002.

10. Energex, September 2002.

Other references

ACCC (Australian Competition and Consumer Commission) 2000, *Queensland Gas Pipelines Access Regime: Assessment of tender processes and reference tariff outcomes*, May.

— 2001, *Access Arrangement proposed by Epic Energy Queensland Pty Ltd for the Ballera to Wallumbilla Pipeline System, Final Decision*, 28 November.

— 2002a, *Access Arrangement proposed by APT Petroleum Pipelines Ltd for the Wallumbilla to Brisbane Pipeline System, Final Decision*, 16 January 2002.

— 2002b, *Access Arrangement proposed by the Carpentaria Gas Pipeline Joint Venture for the Ballera to Mount Isa Pipeline, Final Decision* 16 January 2002.

COAG (Council of Australian Governments) 1997, *Natural Gas Pipeline Access Agreement*, November.

CS Energy Limited 2001, *Carpentaria Gas Pipeline Access Principles: Submission to the ACCC*, January.

Energex 2001, *Comments to the ACCC on the Access Arrangements for the Roma to Brisbane pipeline*, February.

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— 1998, *South Australian Access Regime for Gas Pipeline Services: Statement of Reasons*, September.

— 1999a, *NSW Access Regime for Gas Pipeline Services: Recommendation on Effectiveness*, March.

— 1999b, *WA Rail Access Regime, Draft Recommendation*, September.

— 2000a, *Western Australian Access Regime for Gas Pipeline Services: Statement of Reasons*, February.

— 2000b, *Australasia Rail Access Regime, Final Recommendation*, February.

— 2000c, *ACT Access Regime for Gas Pipeline Services: Statement of Reasons*, July.

— 2000d, *NT Electricity Networks Access Code, Draft Recommendation*, September.

— 2001a, *Legislation Review of Clause 6 of the Competition Principles Agreement and Part IIIA of the Trade Practices Act 1974: Submission to the Productivity Commission*, January.

— 2001b, *Northern Territory Access Regime for Gas Pipeline Services: Recommendation on Certification*, June.

— 2001c, *Review of the National Access Regime: Submission in Response to the Productivity Commission's Position Paper*, July.

Productivity Commission 2001, *Review of the National Access Regime: Position Paper*, March.

Queensland Government 1998, *Application to the National Competition Council for a Recommendation on the Effectiveness of the Queensland Third Party Access Regime for Natural Gas Pipelines*, August.

— 2000b, *Response to the Concerns Raised by the Australian Competition and Consumer Commission with regard to the Queensland Gas Access Regime*, November.

— 2001, *Application for Certification of Queensland's Gas Pipeline Access Regime: Submission by the Queensland Government to the Minister for Financial Services and Regulation.*

Santos 2000, *Submission to the ACCC on the Wallumbilla to Rockhampton via Gladstone Access Arrangement*, October.

Santos 2001a, *Roma to Brisbane Pipeline Access Arrangement: Public Submission to the ACCC*, January.

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