Submission of the National Competition Council to the Productivity Commission review of the National Gas Access Regime

September 2003

TABLE OF CONTENTS

1 Introduction

1.1 In February 1994, the Council of Australian Governments (CoAG) agreed to remove impediments to free and fair trade in natural gas. A central element of the reform process has been the development of a National Gas Access Regime (the Gas regime) which applies to natural gas transmission and distribution pipeline services

1.2 The Gas Regime comprises: the Gas Pipelines Access Law (GPAL), which provides the legal framework for the regime; supporting state and territory legislation and regulations; and the National Third Party Access Code for National Gas Pipeline Systems (the Gas Code). South Australia was the lead legislator, with all other jurisdictions enacting the Gas Regime through an application of the South Australian law.

1.3 The Gas Regime works by applying the Gas Code to all covered pipelines. The Gas Code establishes the mechanisms and principles under which pipeline operators will offer access. The Gas Code has a number of core elements:

(a) coverage criteria;

(b) access arrangements;

(c) ring fencing;

(d) dispute resolution; and

(e) appeals.

1.4 The Gas Code is operational in all jurisdictions. The Regime has been certified as an effective access regime under Part IIIA of the TPA in all States and Territories other than Queensland and Tasmania.

1.5 Part IIIA and clause 6 of the CPA outline both the principles for identification of infrastructure services where regulation is appropriate and the principles for designing access regimes to effectively regulate those identified services. The Council considers, in essence, that the requirements for certification as an effective access regime are:

(a) appropriate coverage of services; appropriate treatment of interstate issues;

(b) an effective model to facilitate access and competition, including scope for commercial negotiation underpinned by an independent regulatory framework;

(c) independent and binding dispute resolution; and

(d) appropriate guidance to the arbitrator and regulator.

1.6 The Council considers that the National Gas Code meets these requirements. The National Gas Code requires service providers to develop and have approved access arrangements for covered pipelines. Access arrangements must meet the requirements of the Code in addressing issues such as pricing, information provision, trading and queuing policies. However, the Code's requirements allow service providers considerable discretion in how to structure their access arrangements and the approaches they can take in addressing the requirements. This flexibility, combined with parties ability to negotiate outside an access arrangement, means that the National Gas Code is more light handed in its regulation of gas pipelines than regimes in countries such as the United States and is also more light handed than other regulatory regimes in Australia.

1.7 The Council recognises that the application of the Code inevitably imposes costs and burdens on service providers and it is necessary to ensure that this imposition does not hinder the efficient development and operation of gas pipeline services. It is therefore necessary to ensure that the requirements of the Code are the minimum necessary to deliver its stated objective.

1.8 While the Code has now been in operation for five years in some jurisdictions, it is only now that the regulators are concluding the first round of access arrangements for some pipeline services. The finalisation of the first round of access arrangements has been a resource intensive and complex process as service providers, users, regulators and other interested parties have had to understand the requirements of a new regulatory system. For many service providers, the application of the Code was the first time they had been subject to economic regulation and required significant adjustments to how they operate their business and the information they now need to provide to regulators and users. The Council would expect that while the second round of access arrangements will have their own particular issues,

there should be a greater understanding of the requirements of the Code and the processes should be less complex, more timely and less onerous.

1.9 The Council's experience to date with the coverage and revocation processes is that the Gas Code currently applies to significantly fewer pipelines, especially transmission pipelines, than anticipated by governments in the 1997 Natural Gas Pipelines Access Agreement.

1.10 While there has been criticism of the Gas Code and associated administrative arrangements by transmission pipeline interests, this criticism has coincided with a sharp increase in interest in the exploration and development of gas fields and in the construction of new transmission pipelines. There is interest in the development of gas resources in Bass Strait, the Cooper Basin, the Otway Basin, the Timor Sea and elsewhere. Since the introduction of the Gas Code new transmission pipelines have been constructed between Victoria and New South Wales, ACT, South Australia and Tasmania. Other pipeline proposals include linking gas fields in Timor Sea and Papua New Guinea to Queensland and possibly southeast Australia. In the light of this, the proposition that the Gas Code is currently deterring investment in new transmission pipelines appears difficult to sustain.

1.11 This does not mean that the Gas Code, and its current application to gas pipelines, should never change. In fact, it seems likely that as transmission pipeline infrastructure in Australia is developed, and more choices become available to gas producers, retailers and users, fewer pipelines will have substantial market power and the ability to profitably restrict competition in gas markets such that coverage under the Gas Code is appropriate. Further, as the culture of doing business in effectively competitive gas markets becomes entrenched, it may be appropriate to further lighten the level of regulatory intervention in the Gas Code.

1.12 But in the context of the current state of development of the gas industry, the Gas Code in its current form appears appropriate and is certainly not fundamentally flawed. Further, as clearly recognised by governments in all the relevant inter-governmental agreements, gas access regulation is a crucial element in the development of a competitive gas industry Australia-wide.

1.13 The Council considers that gas reform has been one of the success stories of NCP implementation. However, it will be some years before

the full impact of this policy reform implementation will be realised. Lags between policy reform and market outcomes are common. However, the evidence to date is that gas policy reform under NCP has already generated substantial activity in the development of new gas production and gas pipelines. Current policy settings have created the environment for effective competition in gas markets.

1.14 This submission provides the Council's views on the Gas Access Regime, its operation to date and proposes a number of amendments to improve its operation. The submission draws on the Council's experience with the coverage and revocation processes under the regime as well as the Council experience is assessing effective access regimes under Part IIIA of the *Trade Practices Act 1974*.

2 The object of the gas access regime

A single object

2.1 In its *Review of the Gas Access Regime Issues Paper* (July 2003) (Issues Paper), the Productivity Commission (the Commission) asks a series of questions about the stated objectives of the Gas Access Regime and how those objectives inter-relate. The Commission asks:

(a) Are improvements needed to the objectives specified in the preamble to the Gas Pipelines Access Act in order to ensure uniform third party access arrangements are implemented and applied on a consistent, national basis?

(b) To what extent, if any, is there conflict between the objectives stated in the preamble to the Gas Pipeline Access Act? Have such conflicts been resolved satisfactorily by regulators, the courts and other relevant parties? If not, what improvements could be made?

(c) Are there any problems or ambiguities arising from the hierarchical structure of the various sets of objectives contained in the Gas Pipeline Access Acts and the National Third Party Access Gas Code for Natural Gas Pipelines Systems (Gas Code)? Have these conflicts and ambiguities been resolved satisfactorily by regulators, the courts and other relevant parties? If not, what improvements could be made?

2.2 These questions implicitly assume the appropriateness of multiple objectives within the legislative instruments and then focus on seeking clarity and some prioritisation of those objectives. The nature of access regulation is such that it will necessarily involve the balancing of a range of interests and that it will require a variety of factors to be taken into account.

2.3 The role of an objective in a statute is to identify the core purpose of the legislation which is to be used as the guiding principle in interpreting particular provisions in the legislation. An objective thus ensures that

no matter the particular decision being made it is being taken with regard to one clear overall objective which the legislature is seeking to achieve.

2.4 This desire for a clear objective is not a novel concept. The Commission has previously noted the desirability of clear objectives. In its *Review of the National Access Regime Inquiry* (National Access Regime Review) the Commission stated:

> *clear specification of objectives is fundamental to all regulations. It is particularly important where there is scope for diversions between the intent of regulation and the interpretation of its operational criteria.* (PC 2001, p. 124)

2.5 The National Competition Council (Council) has also previously recognised the desirability of clear objectives. In its submission to the Commission's Review of the National Access Regime, the Council supported the proposed introduction of an objects clause in Part IIIA of the *Trade Practices Act 1974* (Part IIIA), stating:

> *The Council believes that including the proposed objects clause would make explicit what has been implicit, and that the clarity this engenders would improve the efficacy of Part IIIA, as well as access regimes under the Part IIIA umbrella such as the Gas Code.* (NCC 2001a, p. 9)

2.6 As noted by the Commission in the Issues Paper, at present there are a number of competing objectives expressed throughout the various Gas Pipelines Access Acts and the Gas Code. Each Gas Pipelines Access Act contains a preamble that reiterates the objectives of the 1997 Natural Gas Pipelines Access Agreement to create a uniform national framework for third party access to gas pipelines that:

(a) facilitates the development and operation of a national market for natural gas; and

(b) prevents abuse of monopoly power; and

(c) promotes a competitive market for natural gas in which customers may choose suppliers, including producers, retailers and traders; and

(d) provides rights of access to natural gas pipelines on conditions that are fair and reasonable for the owners and operators of gas

transmission and distribution pipelines and persons wishing to use the services of those pipelines; and

(e) provides for resolution of disputes.

2.7 The Gas Code also replicates these objectives in the Introduction, and then proceeds to list further objectives throughout the body of the Gas Code. For example, section 8.1 of the Gas Code specifies a further list of objectives in relation to the setting of Reference Tariffs. The Commission notes in the Issues Paper that "the existence of these multiple objectives may oblige regulators to make trade-offs between different goals". (PC 2003, p. 15)

2.8 The problem which arises from such a multiplicity of objectives is well described in the judgment of McHugh, Gummow, Kirby and Hayne JJ in *Project Blue Sky Inc v Australian Broadcasting Authority*[1] where they said:

> *"A legislative instrument must be construed on the prima facie basis that its provisions are intended to give effect to harmonious goals.[2] Where conflict appears to arise from the language of particular provisions, the conflict must be alleviated, so far as possible, by adjusting the meaning of the competing provisions to achieve that result which will best give effect to the purpose and language of those provisions while maintaining the unity of all the statutory provisions.[3] Reconciling conflicting provisions will often require the court "to determine which is the leading provision and which the subordinate provision, and which must give way to the other".[4] Only by determining the hierarchy of the provisions will it be possible in many cases to give each provision the meaning which best gives effect to its purpose and language while maintaining the unity of the statutory scheme.*
>
> *Furthermore, a court construing a statutory provision must strive to give meaning to every word of the provision.[5]".*

---

1 1998) 194 CLR 355

2 *Ross v R* (1979) 141 CLR 432 at 440; 25 ALR 137 per Gibbs J

3 See *Australian Alliance Assurance Co Ltd v Attorney-General of Queensland* [1916] St R Qd 135 at 161 per Cooper CJ; *Minister for Resources v Dover Fisheries* (1993) 43 FCR 565 at 574-116 ALR 54 at 63 per Gummow J

4 *Institute of Patent Agents v Lockwood* [1894] AC 347 at 360 per Lord Herschell LC

5 *Commonwealth v Baume* (1905) 2 CLR 405 at 414 per Griffith CJ, 419 per O'Connor J; *Chu Kheng Lim v Minister for Immigration, Local Government and Ethnic Affairs* (1992) 176 CLR 1 at 12-13; 110 ALR 97 per Mason CJ

2.9 There is currently some uncertainty as to the weight that should be given to the competing objectives in the Gas Code and the decision in *Re Dr Ken Michael AM; ex parte Epic Energy (WA) Nominees Pty Ltd and Anor* (2002) 25 WAR 511 (Epic decision) has not provided further clarification to the relative priorities of the various objectives.[6]

2.10 The Council submits that the best way to achieve the desired outcome of clear objectives is to have as the single object of economic efficiency as reflected in the following statement:

> *The object of the Gas Access Regime and Gas Code is to promote the economically efficient operation and use of, and investment in, gas distribution and transmission pipelines.*

2.11 The Council submits that this object should then be the guiding principle for:

(a) interpretation and application of coverage criteria; and

(b) regulation of covered pipelines, including the exercise by the relevant regulator of their discretion.

---

6 These competing objectives have been noted by the Court in *Re Dr Ken Michael AM; ex parte Epic Energy (WA) Nominees Pty Ltd and Anor* (2002) 25 WAR 511.

3 Coverage

3.1 The Issues Paper asks the following questions concerning coverage under the Gas Code:

(a) Is the current coverage test and its application appropriate? If not, why and how could the coverage test be improved?

(b) To what extent has the option to revoke coverage been utilised? Are any improvements required?

(c) How consistent should the Gas Code's coverage criteria be with the criteria for declaration in Part IIIA and coverage criteria in other industry-specific regimes?

(d) What changes might be needed to achieve the appropriate level of consistency?

(e) Do you have any views on the Commission's recommendations to the National Access Regime (and the Government Response to National Access Regime) particularly where they are relevant to the industry-specific access arrangements for gas pipelines?

Coverage test is consistent with Part IIIA and Competition Principles Agreement

3.2 The Government, in its interim response to the Commission's review of the National Access regime agreed that Part IIIA should continue to provide a framework and guiding principles for industry-specific access regimes. The Government also supported the proposed objects clause, to be included in Part IIIA, that the second object of Part IIIA is to "*provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry*".

3.3 The Council considers that the current coverage test is appropriate. It is consistent with the principle endorsed by the Government above, and is consistent with the principles established by the Competition Principles Agreement and with the declaration test contained in Part IIIA of the TPA.

3.4 More fundamentally, the coverage test is also consistent with the overall objectives in section 2 of the TPA through "unlocking" natural monopoly infrastructure and in so doing promote competition in related markets" (NCC 2001a, p. 9).

3.5 The Commission in its National Access Regime Review found that "[t]he current emphasis of Part IIIA on the services provided by essential infrastructure facilities is broadly appropriate". It recommended only one amendment to the declaration criterion in Part IIIA (discussed in paragraph 3.42) below. The Council supports adopting a similar approach to the Gas Access Regime.

3.6 The principal differences between the coverage criteria and declaration criteria are addressed in detail in paragraph 3.24 below. Essentially, those differences arise from the use of the defined term "pipeline" in the coverage criterion in place of the word "facility" in the declaration criteria.

3.7 The Council considers that those differences are appropriate and are consistent with the nature of the Gas Access Regime and Gas Code as an industry-specific access regime that was developed pursuant to clause 6 of the Competition Principles Agreement to apply to natural gas transmission and distribution pipelines, where (using the language of clause 6 of the Competition Principles Agreement) it would not be economically feasible to duplicate the pipeline and where access to the service provided by the pipeline is necessary in order to permit effective competition in a downstream or upstream market.

Competition Principles Agreement contemplates state-based regulation of facilities

3.8 The Competition Principles Agreement entered into by the Commonwealth, each of the States, the Northern Territory and the Australian Capital Territory on 11 April 1995 recited:

(a) the agreement of the parties to "the principles of competition policy articulated in the report of the National Competition Policy Review" (Hilmer Review 1993); and

(b) the intention of the parties "to achieve and maintain consistent and complementary competition laws and policies which will apply to all businesses in Australia regardless of ownership".

3.9 The principles of competition policy underlying clause 6 of the Competition Principles Agreement were articulated in Chapter 11 of the Hilmer Review:

> *"Some economic activities exhibit natural monopoly characteristics, in the sense that they cannot be duplicated economically. While it is difficult to define precisely the term 'natural monopoly', electricity transmission grids, telecommunication networks, rail tracks, major pipelines, ports and airports are often given as examples. Some facilities that exhibit these characteristics occupy strategic positions in an industry, and are thus 'essential facilities' in the sense that access to the facility is required if a business is to be able to compete effectively in upstream or downstream markets." (emphasis added)* (Hilmer Review 1993, p. 240)

3.10 Clause 6 of the Competition Principles Agreement dealt with "[a]ccess to services covered by significant infrastructure facilities".

3.11 Sub-clause 6(1) required the Commonwealth to "put forward legislation to establish a regime for third party access to services provided by means of significant infrastructure facilities" where, amongst other things:

(a) "it would not be economically feasible to duplicate the facility"; and

(b) "access to the service is necessary in order to permit effective competition in a downstream or upstream market".

3.12 However, sub-clause 6(2) of the Competition Principles Agreement made clear that the scheme established by the Commonwealth legislation was "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" (emphasis added) unless the Council determined that the regime was ineffective.

3.13 Paragraph 6(3)(a) replicated subclause 6(1) by imposing as a requirement for a State or Territory access regime to conform to the principles set out in the clause, it should "apply to services provided by

means of significant infrastructure facilities where", amongst other things:

(a) "it would not be economically feasible to duplicate the facility"; and

(b) "access to the service is necessary in order to permit effective competition in a downstream or upstream market".

3.14 The Commonwealth legislation contemplated by subclause 6(1) of the Competition Policy Agreement is constituted by Part IIIA which was introduced by the *Competition Policy Reform Act 1995* (Cth) and commenced on 6 November 1995.[7]

3.15 The Gas Pipelines Access Acts were enacted to constitute legislation in the nature of that contemplated by subclause 6(2) of the Competition Policy Agreement. The legislation was facilitated by the Natural Gas Pipelines Access Agreement — agreed by the Commonwealth, State and Territory Governments in 1997.

3.16 The Natural Gas Pipelines Access Agreement had as its objective the development of a uniform national framework for third party access to natural gas pipelines. The Natural Gas Pipelines Access Agreement provided specifically for the uniform enactment by the States and Territories of both the Gas Pipelines Access Law and the Gas Code.

3.17 The introduction to the Gas Code (and the preamble to the South Australian Act) emphasise both its place within the general regulatory regime established by the Competition Principles Agreement and its particular focus as reflected in the objectives of the Natural Gas Pipelines Access Agreement. The introduction to the Gas Code states:

> *"This Gas Code establishes a national access regime for natural gas pipeline systems.*
>
> *The objective of this Gas Code is to establish a framework for third party access to gas pipelines that:*
>
> *(a) facilitates the development and operation of a national market for natural gas; and*

---

7 *Rail Access Corporation v New South Wales Minerals Council* (1998) 87 FCR 517 at 518-519

(b) prevents abuse of monopoly power; and

(c) promotes a competitive market for natural gas in which customers may choose suppliers, including producers, retailers and traders; and

(d) provides rights of access to natural gas pipelines on conditions that are fair and reasonable for both Service Providers and Users; and

(e) provides for resolution of disputes."

3.18 The Council considers that the recommendations of the Commission concerning the National Access Regime, the Government's interim response to those recommendations, the legislative history of Part IIIA and the Gas Access Acts, together with the developing body of case law concerning the interpretation of the coverage criteria and the declaration criteria, justify retaining the existing coverage test.

Coverage test is consistent with declaration test

3.19 Notwithstanding the distinction in the Competition Principles Agreement between declared services and regulated facilities, the two coverage criteria that have attracted the most attention, criteria (a) and (b), largely mirror the corresponding criteria for declaration under Part IIIA.

3.20 Consistently with subclause 6(1) of the Competition Principles Agreement, section 44G(2) of the TPA allows for the Council to recommend, and section 44H(4) allows for the Minister to declare, a service to be subject to Part IIIA if, but only if, satisfied, amongst other things:

(a) "that access (or increased access) to the service would promote competition in at least one market (whether or not in Australia), other than the market for the service"[paragraph (a)]; and

(b) "that it would be uneconomical for anyone to develop another facility to provide the service"[paragraph (b)].

3.21 Consistently with subclause 6(2) of the Competition Principles Agreement, the Council and the Minister must also be satisfied that

"access to the service is not already the subject of an effective access regime" [paragraph (e)]. For State and Territory access regimes, that status must be determined applying the principles set out in the Competition Principles Agreement [subsections 44G(3) and 44H(5)]. Section 44M provides for the Council to recommend, and section 44N allows for the Minister to determine, that a regime established by a State or Territory for access to a service has the status of an "effective access regime".

3.22 Consistently with subclause 6(3) of the Competition Principles Agreement, section 1.9 of the Gas Code allows for the Council to recommend, and section 1.15 allows for the relevant Minister to determine, that a Pipeline be covered by the Gas Code if and only if satisfied, amongst other things:

(a) "that access (or increased access) to Services provided by means of the Pipeline would promote competition in at least one market (whether or not in Australia), other than the market for the Services provided by means of the Pipeline" [criterion (a)]; and

(b) that it would be uneconomic for anyone to develop another Pipeline to provide the Services provided by means of the Pipeline" [criterion (b)].

3.23 The Government's interim response to the National Access Regime suggests that no fundamental changes are likely to be made to Part IIIA or the Competition Principles Agreement[8]. For the reasons set out in its submissions to the Commission during the course of that review, the Council supports that approach. In light of the approach, the Council strongly supports retaining the current coverage test substantially in its current form.

---

8 Government Response to Productivity Commission Report on the Review of the National Access Regime 17 September 2002, p.1

Developing jurisprudence supports consistency between coverage criteria and declaration criteria

3.24 There is developing a body of jurisprudence concerning the interpretation of the coverage and declaration criteria. This is demonstrated by the Tribunal's decision in *Re Review of declaration of freight handling services at Sydney International Airport* (2000) ATPR ¶41–754 (Sydney Airport decision) in 2000 and in *Duke Eastern Gas Pipeline Pty Ltd (2001) ATPR 41–821* (Duke EGP decision), in which the Tribunal applied the same principles to the interpretation of the coverage test as have been developed in the context of the declaration test. The Council agrees with this approach.

3.25 As each regime is based on clause 6 of the Competition Principles Agreement, to the extent that the language of the coverage and declaration criteria is identical or very similar, the Council considers that they should continue to be interpreted consistently with each other.

3.26 The regulatory context of the Gas Code requires that the language of the coverage criteria in section 1.9 be construed in the light of and consistently with:

(a) the specific objectives of the Gas Code;

(b) the more general purposes disclosed by clause 6 of the Competition Principles Agreement; and

(c) the almost identical language in Part IIIA of the TPA.

3.27 The Tribunal in the Sydney Airport decision (in the course of considering criterion (a)) recognised that what the coverage criteria are essentially designed to target is a facility that "exhibits the features of a natural monopoly" and that is a "bottleneck" in the sense that "access to it is essential in order to compete in upstream or downstream markets". This use of language is consistent with the description of an "essential facility" in the Hilmer Review and the Second Reading Speech to the

Competition Policy Reform Act[9] and therefore with the intention of clause 6 of the Competition Principles Agreement.

3.28 The structure of the coverage criteria can be described as being that:

(a) criterion (b) is concerned with identifying those facilities which exhibit "natural monopoly characteristics"; and

(b) criterion (a) is concerned with identifying those facilities access to which is necessary in order to promote competition in an upstream or downstream market.

3.29 Together, criteria (a) and (b) identify facilities that can be appropriately labelled a "bottleneck".

3.30 While the statutory language should be interpreted by reference to the underlying economic rationale, it is entirely inappropriate to substitute economic terminology for the statutory language. This is particularly so in the light of the lack of precision attending the economic terms themselves. The Hilmer Review specifically recognised the difficulty of defining a "natural monopoly" and the word "bottleneck" has not been suggested to have a technical connotation.

3.31 In the *Eastern Gas Pipeline* matter, the Tribunal briefly set out the history of access regulation in Australia concerning Part IIIA and the Gas Code and endorsed and adopted the approach taken by the Tribunal in the *Sydney International Airport* matter in interpreting a number of provisions of the Gas Code consistently with the Tribunal's interpretation of the corresponding provisions in Part IIIA. Those matters were as follows:

3.32 The enquiry required by criterion (a) is an enquiry as to the future with coverage and without coverage (para 74);

(a) That criterion (a) is concerned with the removal of barriers to entry which inhibit the opportunity for competition in the relevant dependent market. The notion of promotion of competition involves a consideration that if the conditions or environment for improving competition are enhanced, then there is a likelihood of increased competition that is not trivial (para 75); and

---

9 Second Reading Speech Competition Policy Reform Bill, 30 June 1995, Hansard, p2799.

(b) Its formulation of the test required by criterion (b),that is, if a single pipeline can meet market demand at less cost (after taking into account productive allocative and dynamic effects) than two or more pipelines, it would be "uneconomic", in terms of criterion (b), to develop another pipeline to provide the same services (para 64).

3.33 The objects clause proposed by the Council is intended to encapsulate the guiding principle of access regulation in Australia, that is, the objective of community welfare enhancement, or efficiency which is consistent with general economic thinking on the appropriate role of economic regulation such as Part IIIA and the Gas Access Regime.

3.34 The Council considers that this developing body of precedent, together with the introduction of a single objects clause, provides sufficient guidance to regulators, services providers and access seekers as to the interpretation of the coverage criteria and that no major changes to the coverage criteria are necessary.

No changes to the coverage criteria are required to achieve consistency with Part IIIA

3.35 The Council notes that in certain respects, the language of the coverage criteria differs from the language of the declaration criteria under Part IIIA. However, notwithstanding these differences, the Council does not consider that any changes to the coverage criteria under the Gas Code are required, either to ensure that they are identical to Part IIIA or to improve the operation of the Gas Code.

3.36 The coverage criteria differ in their wording to the corresponding declaration criteria under Part IIIA as underlined in Table 1.

Table 1

Gas Code	*Part IIIA*
1.9(a): that access (or increased access) to Services provided by means of the Pipeline would promote competition in at least one market (whether or not in Australia), other than the market for the Services provided by means of the pipeline.	Section 44H(4)(a): that access (or increased access) to the Service would promote competition in at least one market (whether or not in Australia), other than the market for the Service.
1.9(b): that it would be uneconomic for anyone to develop another Pipeline to	Section 44H(4)(b): that it would be uneconomical for anyone to develop

provide the Services provided by means of the Pipeline.	another facility to provide the Service.

3.37 The principal difference in the operation of the conditions for declaration under Part IIIA of the TPA and the conditions for coverage under the Gas Code has its origin in the difference in focus between subclauses 6(1) and 6(2) of the Competition Principles Agreement and the increased certainty that was considered to be appropriate in the application of access in arrangements to pipelines.[10]

3.38 The focus of Part IIIA of the TPA, consistently with subclause 6(1) of the Competition Principles Agreement, is to enact a general regime for access to particular services provided by a facility. The focus of the Gas Code, consistently with subclause 6(2) of the Competition Principles Agreement, is on enacting a specific regime for access to the services provided by means of a particular type of facility, namely natural gas pipelines. The nature of this difference is reflected in the differences in the formulation of the criteria under ss.44G(2) and 44H(4) of the TPA and section 1.9 of the Gas Code. The TPA provisions speak of the Council and the Minister being satisfied of certain matters in relation to a particular service. The Gas Code focuses on the particular pipeline: it being contemplated that the pipeline will itself provide many services.[11]

3.39 In general terms, the Council considers that those differences in language are appropriate, given the distinction between "service" and "facility" in clauses 6(1) and 6(2) of the Competition Principles Agreement.

3.40 In particular, the Council does not consider that it is necessary to amend the Gas Code to ensure that its language is:

(a) identical to the language used in Part IIIA; or

(b) to address any of the issues that have been raised concerning the application of the coverage criteria to particular pipelines. Those issues concern:

---

10 See Second Reading Speech of the Hon. R.G Kerin (Minister for Primary Industries, Natural Resources and Regional Development) to the Gas Pipelines Access (South Australia) Bill, 2 December 1997, p2.

11 For example see sections 3.1, 3.2, 3.3(a) and (b) and 10.8 of the Gas Code.

(i) the definition of "services provided by means of the Pipeline"; and

(ii) the utility of criterion (b), in light of the interpretation of that criterion by the Tribunal in the Duke EGP decision.

3.41 These issues concerning the interpretation of each of the coverage criteria and the difference between the wording of the coverage criteria and Part IIIA are addressed in sections 3-6 below.

Proposed amendments to Part IIIA

3.42 The coverage criteria should be broadly consistent with the criteria for declaration in Part IIIA, in order to achieve the overall objectives of access regulation in Australia set out in the Competition Principles Agreement.

3.43 In its response to the Commission's report on Part IIIA, the Government has proposed an amendment to Part IIIA to include the words *"material increase in competition*" in clause 44G(2)(a) to ensure access declarations are only made where the increases in competition are *not trivial*.

3.44 The Council believes such an alteration is unnecessary. In the *Sydney Airport* decision the Tribunal effectively applied the same test. The Tribunal commented that:

> *"It is in this sense that the Tribunal considers the promotion of competition involves a consideration that if the conditions or environment for improving competition are enhanced, then there is a likelihood of increased competition that is not trivial".* (para 107)

3.45 In any event, the Council believes it is important for the sake of consistency that if the declaration criterion is amended to introduce the requirement of a "*material increase in competition*", as proposed by the Government in its response to the Commission's review of Part IIIA, that such an amendment should be included in coverage criterion (a) under the Gas Code.

4 Criterion (b)

Interpretation

4.1 Criterion (b) is concerned with the nature of the facility rather than with the competitive impact of the service provided by means of the facility. In the language of clause 6 of the Competition Principles Agreement, criterion (b) is concerned with whether "it would not be economically feasible to duplicate the facility".

4.2 The two differences between the coverage criteria (b) and the declaration criterion (b) are the use of the word "uneconomic" in place of the word "uneconomical" and the use of the word "Pipeline" in place of the word "facility".

Uneconomic v uneconomical

4.3 The Council considers that there is no material difference between "economic" and "economical" as those words are used in the coverage criteria and the declaration criteria and has adopted this approach in each of the coverage or revocation applications before it as set out in Appendix 1.

4.4 The decision of the Tribunal in *Duke EGP* has established that the "uneconomic to duplicate" test in criterion (b) of Part IIIA is equally applicable to criterion (b) of the Gas Code, that is, if a single pipeline can meet market demand at less cost (after taking into account productive, allocative and dynamic effects) than two or more pipelines, it would be "uneconomic" in terms of criterion (b) to develop another pipeline to provide the same services. As set out in its submission to the Commission in its report into the National Access Regime (NCC 2001, pp. 27-28), the Council considers that this is the correct interpretation of criterion (b), given the overall efficiency objective of access regulation.

4.5 In reaching that decision, the Tribunal applied the interpretation of "uneconomic" established by *Sydney Airport decision* in the context of Part IIIA to establish the meaning of "uneconomical" for the purposes of the coverage criterion under the Gas Code. It noted that:

> *In Sydney International Airport the Tribunal gave attention to the meaning of "uneconomical", where used in the TPA equivalent of criterion (b). Criterion (b) is expressed in terms of whether it would be "uneconomic" (as opposed to "uneconomical") to develop another Pipeline (as opposed to another "Facility"), but at least in the present context, nothing turns upon this difference in language.* (para 57)

Pipeline v facility

4.6 The second difference between coverage criterion (b) and declaration criterion (b) is the use of the word pipeline in place of the word facility.

4.7 As set out above, the Tribunal considered that "nothing turned" on the difference in language between "another pipeline" as opposed to "another facility" in the context of the *Duke EGP* decision. In that case, the relevant issue was whether it was economic to develop the Interconnect[12] (through additional compression or looping) to provide the service of transportation of natural gas between Longford and Sydney and places in between (being the service provided by means of the Duke Eastern Gas Pipeline). There was no suggestion that any facility other than a pipeline could be developed that could provide those services.

4.8 The Council notes that a criticism of the current interpretation of criterion (b) may be that gas pipelines in Australia will usually satisfy the criterion. This criticism is based largely on the definition of "services provided by means of the pipeline" established by the Tribunal in Duke EGP decision as the transportation of natural gas from the origin to the destination and points in between, which definition relies on the origin and destination and off-take points of the relevant pipeline. Such a "point to point" service definition, limited as it is to the origin and destination of the pipeline, may have the consequence that it is only another pipeline between those points which can mean that (b) is not satisfied. To avoid this consequence, it may be submitted to the Commission that:

---

12 The Interconnect is the pipeline between Wagga Wagga and Albury/Wodonga connecting the NSW and Victorian gas networks. The portion between Wagga Wagga and Culcairn in NSW is owned by East Australian Pipeline Limited, the owner of the Moomba to Sydney Pipeline System, and the portion running from Culcairn to Barnawartha in Victoria (which crosses the border) is owned by GPU GasNet

(a) the service definition should be amended; or

(b) the word "pipeline" should be replaced with the word "facility" in criterion (b).

4.9 As a preliminary matter, it is not surprising that gas pipelines may generally satisfy criterion (b). As the Tribunal noted in *Re. AGL Cooper Basin Natural Gas Supply Arrangements* (1997) ATPR 41-593 at 44, 182:

> *"[g]as transmission pipelines in Australia typically constitute a natural monopoly in that alternative pipelines connecting seller and buyer do not exist."*

4.10 The Gas Access Regime and Gas Code in their current terms only apply to the transportation of natural gas which has been processed to be suitable for consumption: see definition of "Natural Gas" in Appendix 1 to Schedule 1 of *Gas Pipelines Access (South Australia) Act 1997*. Currently, the Council understands that such natural gas is transported by gas pipelines and by no other means of transport. However, the Council acknowledges that it is possible that technological developments may result in the development of other means to transport natural gas in the future.

4.11 Notwithstanding this possibility, the Council considers that criterion (b) in the Gas Code should remain in its current form. The fact that the coverage criteria might readily be satisfied in the case of a gas transmission pipeline should not be regarded as an unlikely or unintended legislative outcome.

4.12 The decision to revoke coverage of the Parmelia Pipeline demonstrates that in some cases, gas transmission pipelines will not satisfy criterion (b), in its current formulation. The Council in its Final Recommendation on the application by CMS for revocation of coverage of the Parmelia Pipeline[13] was not satisfied that it was uneconomic for anyone to develop another Pipeline to provide the services provided by the

---

[13] Parmelia Gas Pipeline (Western Australia):Application for Revocation from Gas Transmission Australia, 31 October 2001. The Parmelia pipeline transports natural gas from the Perth Basin at Dongara to Perth and Pinjarra. It also provides some distribution services in Perth. The application was submitted by CMS Gas Transmission Australia (CMS), the operator of the Parmelia pipeline. On 13 March 2002, the Minister decided to revoke coverage of the Parmelia pipeline.

Parmelia Pipeline, given the existence of the Dampier to Bunbury pipeline and the ability to expand the capacity of that pipeline to transport gas from the Perth Basin to Perth. Similarly, in determining the Duke EGP decision, the Tribunal was required to consider carefully whether it was economical to expand the capacity of the Interconnect, through additional compression and looping to meet demand for the Service provided by means of the EGP (paras 55-57, 133-137), that is, the transportation of natural gas from Longford to Sydney and points in between (paras 138-144). While ultimately, on the facts before it, the Tribunal formed the view that it was not economic to do so, its consideration of this issue demonstrates the role played by criterion (b).

4.13 The fact that a pipeline may satisfy criterion (b) does not mean that it will satisfy each of the other coverage criteria. The existence of other modes of transportation of gas from the origin to the destination between which the relevant pipeline transports gas, or the existence of other pipelines which transport gas from the origin (to another destination) or from another origin to the destination, are matters which the decision maker is required to take into account in its consideration of criterion (a). This is clearly demonstrated by the Tribunal's decision in the Duke EGP decision.

4.14 Replacing the word "pipeline" with the word "facility" in order to ensure that Part IIIA and the Gas Code are identical would have significant consequences for the definition of "service" as clarified by the Tribunal in the Duke EGP decision. In the context of transportation services provided by gas pipelines, replacing the word "pipeline" with the words "another facility" raises the possibility of a blurring of the service definition, to include both the service provided by the facility which the legislature has identified as infrastructure to which access regulation should be directed and other services provided by means of other, unidentified facilities. Such a blurring of the definition of service would be contrary to the fundamental basis of access regulation in Australia, that is, to provide third parties with access to services provided by facilities with natural monopoly characteristics.

Appropriateness of service definition adopted by *Duke EGP* decision

4.15 The Council supports the approach to the definition of "Service provided by means of the pipeline" established by the decision of the Tribunal in *Duke EGP*. Criterion (b) is intended to identify services provided by means of facilities which exhibit natural monopoly characteristics. By contrast, criterion (a) considers the upstream and downstream markets for those services. The Council submits that it is important to maintain this distinction, to ensure consistency with the principles of access regulation articulated in the Competition Principles Agreement.

4.16 A central issue in the Duke EGP decision was whether the services provided by the Eastern Gas Pipeline were to be described by reference to the start and end points of the gas transportation service or by reference to the markets served by that transportation service.

4.17 In analysing this issue in the context of the Gas Code, the question about service identification is: what is the pipeline owner selling and a gas trader or gas user purchasing from that pipeline owner (or what service could be bought and sold)? That defines the relevant service. Such an approach is consistent both with the correct statutory interpretation and with economic analysis.

4.18 In other words, the correct approach is to define the product that is sold (that is, the service) and then test for substitutes for that product to define market boundaries for that service. An approach that seeks to delineate a market and then define the relevant product by reference to that market runs counter to logic. The starting point must be to define the thing that is traded - only then is it possible to test for substitutes. The idea of introducing market analysis into the very delineation of a service risks choosing the wrong market as a starting point. This may involve an inappropriate assumption about relevant substitutes and/or confuse the distinction between the market in which the service is provided and the relevant downstream market.

4.19 The identification of the service arises independently of the market or markets in which those services are supplied (*Duke EGP decision*, para 67). Service delineation is precisely equivalent to the product identification that occurs in standard competition analysis. What is it

that is being offered or is capable of being offered by the infrastructure in question?

4.20 Service delineation should not be confused with the subsequent testing for substitutes for that service, which is necessary to determine the market for the service. As the Tribunal said in the Duke EGP decision:

> *The question of what constitutes the services provided by the pipeline is fundamentally a mixed question of fact and the proper construction of criterion (b), rather than a matter of economic analysis. Every haulage service will of necessity be from one point to another. That is the commercial service actually provided by the pipeline operator to its customers. That service may be of different use to the producers in the origin market or the customers in the destination market, but it is the same service. No market analysis is necessary or appropriate in the description of the services provided by the pipeline.* (para 69)

4.21 Under Part IIIA, it is the service that is subject to declaration that then becomes the service that is the subject of the determination of terms and conditions through negotiation/arbitration. Under the Gas Code, while it is the pipeline which is covered, coverage of a pipeline gives access seekers the ability to negotiate access to services provided by means of that pipeline. Generally, it does not make sense to negotiate or arbitrate terms and conditions of access in relation to a "delivery to a particular market transportation service" or a "delivery for a particular purpose" transport service. Transportation services inherently involve the movement of things or people from one point to another. Therefore, two gas haulage services delivered into a common market from quite separate gas basins are not one and the same service.

4.22 For example, in its application for revocation of coverage of the Goldfields Gas Pipeline, the applicant identified the service provided by means of the GGP as "the transportation of gas for the purpose of generating electricity as part of an interconnected Western Australian energy transmission network[14]. The Council considers that this approach confuses service definition with market definition, which is a separate exercise which is properly undertaken in the analysis of criterion (a). The Council also considers that the way in which the "service" is defined needs to be commercially meaningful. The service is

---

[14] Goldfields Gas Transmission Pty Ltd Application for Revocation of Coverage of the Goldfields Gas Pipeline under the National Gas Access Regime 26 March 2003 p. 60

the thing which is bought or sold or for which there are potential transactions. While different customers may have a different use for the service, the service remains the same service. This is the approach taken by the Tribunal in the Duke EGP decision and the Council supports and adopts this approach. (NCC 2003)

5 Criterion (a)

Interpretation

5.1 Criterion 1.9(a) requires the Council to consider whether or not it is satisfied "that access (or increased access) to Services provided by means of the Pipeline would promote competition in at least one market (whether or not in Australia), other than the market for the Services provided by means of the Pipeline".

5.2 The decision of the Tribunal in *Duke EGP* demonstrates that:

(a) coverage criterion (a) is interpreted consistently with declaration criterion (a); and

(b) criterion (a) plays a significant role in determining whether a pipeline is to be covered.

Promotion of competition

5.3 Criterion (a) is directly concerned with the competitive impact of the service provided by means of the pipeline in dependent markets. In the language of clause 6 of the Competition Principles Agreement, criterion (a) is concerned with the circumstance where "access to the service is necessary in order to permit effective competition in a downstream or upstream market". Criterion (a) therefore requires consideration of whether regulated access under the Gas Code would promote competition in a dependent market.

5.4 Promotion of competition refers to improving the opportunities and environment for competition such that competitive outcomes are more likely to occur. In considering s.44H(4)(a) of the TPA, the Tribunal in the *Sydney Airport decision* made the following observations on the promotion of competition test:

> *The Tribunal does not consider that the notion of "promoting" competition in s 44H(4)(a) requires it to be satisfied that there would be an advance in competition in the sense that competition would be increased. Rather, the Tribunal considers that the notion of*

"promoting" competition in s 44H(4)(a) involves the idea of creating the conditions or environment for improving competition from what it would be otherwise. That is to say, the opportunities and environment for competition given declaration, will be better than they would be without declaration.

We have reached this conclusion having had regard, in particular, to the two stage process of the Part IIIA access regime. The purpose of an access declaration is to unlock a bottleneck so that competition can be promoted in a market other than the market for the service. The emphasis is on "access", which leads us to the view that [section] 44H(4)(a) is concerned with the fostering of competition, that is to say it is concerned with the removal of barriers to entry which inhibit the opportunity for competition in the relevant downstream market. It is in this sense that the Tribunal considers that the promotion of competition involves a consideration that if the conditions or environment for improving competition are enhanced, then there is a likelihood of increased competition that is not trivial. (paras 106-107)

5.5 The Tribunal added:

The Tribunal is concerned with furthering competition in a forward looking way, not furthering a particular type or number of competitors. In this matter, therefore, the Tribunal must be reasonably satisfied that declaration would, looking forward, improve on the competitive conditions in the relevant markets that are likely to exist as a result of the [Sydney Airports Corporation Limited] tender process as compared with a situation where there was no declaration. (para 108)

5.6 The Tribunal in the Duke EGP decision endorsed this approach:

The Tribunal [in the Sydney Airport decision 2000] concluded that the TPA analogue of criterion (a) is concerned with the removal of barriers to entry which inhibit the opportunity for competition in the relevant downstream market. It is in this sense that the notion of promotion of competition involves a consideration that if the conditions or environment for improving competition are enhanced, then there is a likelihood of increased competition that is not trivial. We agree. (para 75)

5.7 The Council agrees with this approach, for the reasons set out in its submissions for the Commission in its National Access Regime review, and considers that no amendment is required.

Competition with and without access

5.8 It is now well-established by the Tribunal that the "promotion of competition" test under the declaration criterion (a) requires an assessment of whether regulated access would improve the competitive conditions in relevant markets, compared with the conditions likely to exist absent regulation (Sydney Airport decision, para 108).

5.9 The Tribunal endorsed this approach to the coverage criterion (a) in the Duke EGP decision:

> *... the question posed by criterion (a) is whether the creation of the right of access for which the Gas Code provides would promote competition in another market. The enquiry is as to the future with coverage and without coverage. We agree with the approach adopted by the Tribunal in Sydney International Airport in this respect. The Tribunal must have regard to the position as it now stands, insofar as it provides a reliable guide to the future without coverage. Thus, (assuming the present is a reliable guide to the future without) account is to be taken of the Duke Eastern Gas Pipeline as an open access pipeline, and of any other pipelines supplying the upstream or downstream gas markets, in order to determine whether coverage of the Duke Eastern Gas Pipeline would promote competition in at least one of those markets.* (para 74)

Temporal considerations in applying "with and without" test

5.10 The application of the "with and without" test endorsed by the Tribunal in the *Sydney Airport decision* and the *Duke EGP decision* requires the identification of the "with and without" coverage counterfactuals. This includes an assessment of the time period over which the counterfactuals must be considered. This time period is of particular significance to greenfields projects such as the Duke Eastern Gas Pipeline.

5.11 In the Duke EGP decision, the Tribunal had regard to the effects of supply and demand conditions over a ten to fifteen year period (without any detailed analysis of the appropriateness of this time period) (para 118):

> *In [the AGL Cooper Basin supply arrangements decision] at 44,210, the Tribunal specified a period of "perhaps ten or fifteen years" as the future market. This period appears to be sufficient in this case given the uncertainties surrounding the operation of a competitive market and forecasts of demand, the existence of spare capacity and significant long term contracts which expire in 2006, and the time to develop new pipelines and new gas fields. (para 78)*

5.12 Criterion (a) assesses whether coverage would promote the environment for competition in at least one dependent market, compared with conditions absent coverage.

5.13 It is not necessary to establish that more competitive outcomes will actually occur, or will occur within a particular period of time. This reflects that there may be a substantial lead time between a change in the competitive environment and the ability of new entrants to undertake investment. As Ordover and Lehr point out, the emergence of new entry may be a gradual process:

> *Because of other market frictions, entry may be slow in coming. Hence, criterion (a) cannot be taken to mean that coverage would rapidly induce entry relative to the no-coverage benchmark. Rather, we take the criterion to mean that coverage is justified if imposition substantially increases the overall competitive conditions in relevant market(s), including the likelihood of entry. Here, it is important to point out that the mere reduction in impediments to entry could stimulate competition among incumbent firms as the enhanced threat of entry forces the incumbents to act more competitively on all dimensions that matter to consumers (which includes price, conditions of sale, service, and so on)* (Ordover and Lehr 2001, p. 11).

5.14 Notwithstanding that new entry may be slow in coming, criterion (a) requires that more competitive outcomes are likely in the future. This requires consideration of future events and market conditions, including:

(a) likely competitive conditions in dependent markets, looking forward; and

(b) exogenous events that may affect the competitive environment in the future.

5.15 Time horizons may be of particular relevance where access is one of a number of barriers to entry. Criterion (a) would then require

consideration of whether other barriers are likely to remain in place, looking forward . To satisfy criterion (a), the Council must be satisfied that coverage improves the competitive environment such that a credible threat of entry arises.

5.16 The Council's consideration of the applications for revocation of coverage of the MSP (NCC 2002) raised a diversity of views as to the appropriate weight that should be attached to future events. For example, in the *Duke EGP decision*, the Tribunal found that the Moomba to Sydney Pipeline System may become an important supply hub in shipping gas from northern Australia and/or Papua New Guinea to NSW markets, possibly by the middle of this decade (*Duke EGP decision*, paragraph 98). The Tribunal considered this relevant to the promotion of competition test (*Duke EGP decision*, paragraphs 102-103). However, in its submission to the Council in MSP applications, NECG expressly excluded consideration of these proposed developments from its analysis of upstream markets, on the grounds that the plans "remain very uncertain" (NECG 2002, sub. 19, App G, p.6, footnote 13). Ordover and Lehr also considered that the proposals were not sufficiently advanced to be taken into account under criterion (a) (Ordover and Lehr 2001, p.6, footnote 12).

5.17 The Council considers that both short term and longer term horizons are relevant in considering the possible effects on markets of events which may occur, depending on the likelihood of those events occurring and the time frame in which they may occur. As a general rule, the relevance of a future event to the promotion of competition test should reflect the probability of the event occurring. A consideration here is the forecast timing of the event, but other contingencies may also be relevant.

5.18 Noting the changes occurring in energy and gas sales markets, the Council considers it appropriate in consideration of criterion (a) of the Gas Code to attach principal weight to the likely competitive environment in the next five to ten years. Beyond that horizon, an assessment of the relevant probabilities becomes highly speculative.

Market power is central to criterion (a)

5.19 The notion of competition is central to criterion (a) and to Australian trade practices law.

5.20 Competition is a dynamic process, generated by market pressure from alternative sources of supply and demand. In this sense, competition expresses itself as rivalrous market behaviour. The key feature of effective competition is that no one seller (or group of sellers) or buyer (or group of buyers) has sustained and substantial market power.

5.21 The Council considers that it is fundamental to a consideration of criterion (a) to identify the incentives and ability of a pipeline operator to exploit its market power in the transmission market in a dependent market.

5.22 In the *Duke EGP decision*, the Tribunal found that the ability to exercise market power in a dependent market is a key factor in determining whether coverage would promote competition:

> *Whether competition will be promoted by coverage is critically dependent on whether Duke Eastern Gas Pipeline has power in the market for gas transmission which could be used to adversely affect competition in the upstream or downstream markets. There is no simple formula or mechanism for determining whether a market participant will have sufficient power to hinder competition. What is required is consideration of industry and market structure followed by a judgment on their effects on the promotion of competition* (Duke EGP decision, paragraph 116).

5.23 In the *Duke EGP decision*, the Tribunal assessed the Duke Eastern Gas Pipeline's ability to exercise market power in dependent markets by considering aspects of industry and market structure, and by making judgments on the implications of these structural features for the promotion of competition (*Duke EGP decision*, para 116). The Tribunal identified the following as relevant factors in determining whether the Duke Eastern Gas Pipeline could exercise market power in a dependent market:

(a) the demand for gas and consequently, gas transportation into Sydney;

(b) available pipeline capacity to supply that demand;

(c) likely spare capacity;

(d) the commercial imperatives facing Duke Energy;

(e) the countervailing power of other market participants in dependent markets; and

(f) competition from other pipelines (the MSP and Interconnect).

5.24 The Tribunal found that coverage of the Duke Eastern Gas Pipeline would not promote competition in upstream or downstream markets because the pipeline lacks sufficient market power to impede competition.

5.25 The Tribunal's *Duke EGP decision* focussed on pertinent aspects of industry and market structure of specific relevance to the Duke Eastern Gas Pipeline. The Tribunal did not indicate that the list of factors upon which it based its decision was necessarily an exhaustive one for assessing competitive conditions in dependent markets in all instances.

5.26 The Council considers it appropriate and consistent with the Tribunal's decision and general principle to apply a framework for analysing criterion (a), focussing on the ability and incentives open to a pipeline owner to exploit market power in relation to a dependent market. Ordover and Lehr suggested such a framework at the time the Council prepared its recommendation on the application for revocation of coverage of the MSP[15]. The framework proposed by Ordover and Lehr provides a broad analytical framework that encompasses each factor identified by the Tribunal, as well as other relevant factors, and may be applied in a wide range of circumstances. The framework is also consistent with the general concept of "leveraging" market power, which is well established in Part IV of the TPA. The Council supports the analytical framework adopted by Ordover and Lehr.

---

[15] The framework is available in full from the Council's web page at http://www.ncc.gov.au/pdf/REGaMoRe-002.pdf

How an exercise of market power in transportation market can impact on competition in dependent markets

5.27 Ordover and Lehr describe the economic definition of market power as follows:

> *In economics, market power is defined as the ability to profitably raise prices above marginal cost. Any firm – other than a firm operating in a perfectly competitive market – can have, in principle, some ability to raise price above marginal cost: all that is required is that the firm faces a downward-slopping demand curve. Indeed, under some cost conditions, pricing at marginal cost would ruin the firm and is thus a precondition for financial viability. Regulatory concerns arise only if the firm possesses significant and durable market power leading to prices that substantially deviate from proper economic costs and which generate persistent supracompetitive returns. When a firm possesses substantial and durable market power, it is often said to possess "monopoly power." Additionally, a firm with market power may have both an incentive and ability to engage in market strategies designed to protect its monopoly profits and power to the detriment of competition and consumers.* (Ordover and Lehr 2001, p.7)

5.28 Fundamentally, there are two plausible reasons why a pipeline with monopoly power over transport might use this to impact on competition in upstream or downstream markets. First, it may seek to do this to exploit its monopoly position in the market for pipeline services. Second, insofar as the pipeline has vertical interests, it may seek to extend, protect, or exploit whatever market power it may have in either upstream or downstream markets (Ordover and Lehr 2001, p.10). A pipeline with monopoly power over transport might try to achieve these objectives through:

(a) extracting monopoly rents; or

(b) acting in favour of upstream or downstream affiliates.

5.29 Absent an access regime, this can inhibit competition in dependent markets in a number of ways. For example:

(a) monopoly pricing of gas transportation is likely to result in higher delivered gas prices (which would weaken demand for gas) and/or

lower returns in gas production and/or gas sales. These conditions are likely to reduce gas production and distort entry incentives in upstream and downstream markets, weakening the competitive environment in those markets.

(b) using the terms and conditions of pipeline access to disadvantage some firms and advantage others may distort entry incentives in dependent markets (Ordover and Lehr 2001, p.11).

5.30 The Ordover and Lehr framework proposes three lines of inquiry for assessing whether a pipeline owner has the incentive and ability to exploit market power (i.e., inhibit competition) in upstream and/or downstream markets. The lines of inquiry are:

(a) the ability of the relevant pipeline owner to charge monopoly prices for transport services;

(b) the ability of the relevant pipeline owner to engage in explicit or implicit price collusion; and

(c) other incentives and opportunities for the relevant pipeline owner to distort competition in adjacent markets.

5.31 The Ordover and Lehr framework addresses each of the issues identified by the Tribunal in the *Duke EGP decision*. In particular:

(a) the first line of inquiry takes account of the following factors identified by the Tribunal: countervailing market power of other market participants; market behaviour in upstream and downstream markets; competition "between" pipelines, pipeline capacity, gas reserves and demand issues; the role of long-term contracts; evidence on elasticity of demand, including cross-price elasticities;

(b) the second line of inquiry takes account of the following factors identified by the Tribunal: the depth of competition in gas transportation markets, issues of parallel pricing, long-term contracts, price discrimination, information disclosure and the role of spare capacity in constraining market behaviour; and

(c) the third line of inquiry takes account of the following factors identified by the Tribunal: vertical-leveraging issues, market

behaviour, commercial imperatives facing the pipeline, and long-term contracts.

5.32 The Council reiterates that the Ordover and Lehr framework is wholly consistent with the Tribunal's approach, but further develops that approach by providing a robust theoretical framework that may be applied to any coverage matter under the Gas Code.

Impact of monopoly prices on dependent market

5.33 The fundamental objective of the Gas Code and access regulation generally is to promote economic efficiency. Firms with market power may set the price of transportation of natural gas in a way that seeks to raise monopoly rents and so distorts economic efficiency. The Council emphasizes that the elimination of monopoly rents is not an end in itself. The national framework for competition policy ought not to be concerned with the distribution of income. Rather, the nation's competition policy should seek to ensure that market mechanisms work where they can to promote the best use of resources. It is within this wider objective, of promoting efficiency, that the reduction of monopoly rents needs to be seen.

Impact of vertical leveraging on dependent market

5.34 Absent an access regime, a pipeline with monopoly power over transport may seek to leverage its market power into upstream or downstream markets, to maximise profits.

5.35 Specifically, if a pipeline has ownership interests in upstream or downstream markets, it may have an incentive to discriminate in favour of affiliates. Such incentives could exist:

(a) where a firm is vertically integrated, that is, a single firm supplies two or more steps in a functional chain through facilities under integrated ownership; or

(b) where a firm exercises some vertical control, that is, there exists an affiliation or arrangement which favours a down stream firm.

5.36 From an economic view point, just as a vertically integrated upstream monopolist may foreclose downstream rivals to monopolise the downstream market, a vertically separate upstream monopoly can deal on an exclusive basis with the most efficient downstream firm, precluding all downstream competitors, and extract the chosen downstream firm's rents by means of a two-part tariff. The downstream firm earns zero economic profit while the upstream firm secures whatever rent is available in the dependent market. Ignoring the possibility that ownership affects managerial incentives and transaction costs, the resulting market structure, profits of the monopolist and prices paid by consumers for a vertically separate upstream monopolist charging a two part tariff will be no different from the structure, profits and prices of its vertically integrated counterpart.

5.37 Discrimination by a pipeline in favour of its affiliates can manifest in a variety of ways, including the charging of lower prices to affiliates for transport services; or offering services on unequal and inferior terms to non-affiliates in upstream or downstream markets.

5.38 Vertical leveraging of this kind may hinder competition in dependent markets. In particular, it may deter the prospect of entry by independent parties into those markets.

5.39 By "affiliate", the Council does not mean only those entities which fall within the definition of "Associate" under the Gas Code. While the Gas Code contains particular provisions which apply to "Associates" of the service provider of a covered pipeline, the definition of "Associate" under the Gas Code is technical and drawn from the principles now included in the Corporations Act. There are some relationships between pipeline operators and other entities which may not fall within this technical definition of "Associate" but which are relevant for the assessment of criterion (a), in particular the incentives and ability of the pipeline operator to leverage its market power into upstream or downstream markets.

5.40 Such vertical leveraging is a concept which has been recognised by the legislature and the ACCC as being a matter to be considered in assessing whether proposed mergers have the likely effect of substantially lessening competition in a relevant market (see section 50 and the Merger Guidelines). The Merger Guidelines recognise that "vertical relations between firms can range from spot transactions,

through long term contracts and licensing arrangements to common vertical ownership". The Merger Guidelines also recognise that:

> *In certain circumstances vertical integration by a firm with market power at one stage of production or distribution can enable an extension of market power and reduction of competition to occur in a vertically related market. This may involve foreclosure of supply or customers to rivals in the vertically related market. Alternative, vertical integration may pre-empt the development of competition at one vertical level where a vertically integrated incumbent can effect discriminatory access to an essential input; or where the vertically integrated owner of the essential input gains access to commercially sensitive information regarding the downstream activities of its rivals.*
>
> *Vertical acquisitions may also target potential entrants into upstream of downstream markets, forestalling the development of competition.*
>
> *Where vertical integration closes off independent sources of supply or outlets for distribution, barriers to entry and/or expansion may be raised and new entrants may be required to enter at all stages of production and/or distribution. In its consideration of Wattyl's proposed acquisition of Taubmans paints, the Commission considered that exclusive vertical trade dealership and associated retail relationships impeded the entry and expansion of new rivals in the architectural and decorative paints market, by restricting access to retail shelf space.*
>
> *Vertical integration may also enable a firm with market power to increase monopoly profits through price discrimination. As Mason CJ and Wilson J observed in Queensland Wire Industries:*
>
> *... vertical integration may help a monopolist distinguish between customers whose demand is less and more elastic. Where consumers are able to trade amongst themselves, the monopolist cannot discriminate. By integrating vertically it may be possible for a monopolist to prevent this inter-trading. For example, power companies usually own distribution systems. This enables them to discriminate in pricing between residential and commercial users. Therefore, although vertical integration does not by itself mean that a firm has a substantial degree of market power, it may well be the means by which the firm capitalises on that market power.*

5.41 The use of market power in one market to deter entry or competitive conduct in another market is also recognised as contrary to the principles underpinning the TPA. Section 46 of the TPA prohibits a firm

that has substantial market power from taking advantage of that power for a purpose of preventing entry or competitive activity in another market. In the recent *Safeway* decision, the Full Federal Court found that Safeway had taken advantage of its substantial market power in the wholesale market for the acquisition of plant baked bread in Victoria for the purpose of deterring competitive activity in a retail market[16]. The issue of leveraging market power was also an issue argued before the High Court in the recent *Rural Press* proceedings.[17]

5.42 The Council acknowledges that the Gas Code contains provisions which limit the extent to which a covered pipeline can exercise its market power to discriminate in favour of an affiliate in a dependent market (for example, the ring fencing provisions and the Associate Contract provisions).

5.43 While the existence of these provisions suggests that an aim of regulation under the Gas Code is to limit the extent to which a pipeline operator can exercise any market power they have in the upstream or downstream market through favouring an "Associate" and while their application to a covered pipeline is a relevant matter for the decision maker to take into account when applying the "with or without" coverage test, the existence of these provisions says nothing about the incentives or ability of a pipeline operator to exercise its market power in the transport market, absent coverage.

Consequences of Duke EGP decision

5.44 In *Duke EGP*, the Australian Competition Tribunal found that criterion (a) was not met and, in those circumstances, the Eastern Gas Pipeline should not be covered under the provisions of the Gas Code. It did so on the basis of a finding that the Duke Eastern Gas Pipeline did not possess market power and, as a consequence, it would have no ability to distort competition in upstream or downstream markets and accordingly, coverage under the Gas Code would not promote competition in any of those markets.

---

16 *Australian Competition and Consumer Commission v Australian Safeway Stores Pty Ltd (No. 2) [2003] FCAFC 163 (*special leave applications pending)

17 *Rural Press Ltd & Ors v ACCC & Ors* [2003] HCATrans 292 (14 August 2003)

5.45 The finding of an absence of market power was based upon the following matters:

(a) That Duke Eastern Gas Pipeline Pty Ltd as the owner and Duke Australia Operations Pty Limited as the operator, of the Duke Eastern Gas Pipeline had "strong commercial incentives" to increase the throughput of the Duke Eastern Gas Pipeline given its:

(i) high capital cost;

(ii) low operating costs; and

(iii) spare capacity. (*Duke EGP decision*, para 117)

(b) Gas producers have significant countervailing power (*Duke EGP decision*, paras 117-118). In this regard, particular emphasis was placed upon the ability of gas producers in the Gippsland Basin being able to sell gas into the Victorian market and, via the Interconnect into Sydney.

(c) AGL has significant countervailing power in Sydney given its size as the major gas retailer in Sydney.

(d) Over the course of the next ten to fifteen years, there will be spare capacity having regard to the total volume of pipelines serving Sydney and that that spare capacity could be used to defeat a price rise.

(e) Price competition is sufficient to prevent Duke Eastern Gas Pipeline increasing its price because the SSNIP analysis carried out by Henry Ergas suggests that a small increase in price by the Duke Eastern Gas Pipeline could be defeated by the Interconnect at prices below the tariff prevailing for the Duke Eastern Gas Pipeline at the time of the Tribunal decision.

(f) The Interconnect has the capacity to expand and that it expansion capacity would provide a constraint on the Duke Eastern Gas Pipeline.

5.46 Some but not all of these have relevance to the Moomba to Sydney Pipeline. Dealing with each in turn:

(a) It is true that the MSP has high capital costs and low operating costs. There is some spare capacity but less spare capacity than in the case of the Duke Eastern Gas Pipeline.

(b) The options available to gas producers at the Cooper Basin are either the sales of gas via the MSP or via the Moomba to Adelaide Pipeline. The Moomba to Adelaide Pipeline System (MAPS) has a capacity of up to 150pj/a (418tj/d) of which about 127pj/a (438tj/d) is firm capacity throughout the year[18]. The Council understands that the pipeline is fully contracted until the end of 2005.

A significant proportion of the capacity of the Moomba to Sydney Pipeline is committed under the gas Transportation Deed between East Australian Pipelines Limited and AGL Wholesale Gas. It expires on 1 January 2017. It was approved, following amendments, by the ACCC in March 2000 as an associate contract under the Gas Code. Details of its operation are set out in the Council's Final Recommendation on the Moomba to Sydney Pipeline at paras 4.104 to 4.110.

(c) The countervailing power of AGL has significance vis-a-vis the Duke Eastern Gas Pipeline which is owned by an arms length third party. However, AGL has a beneficial interest in APT and accordingly, there is no relevant countervailing power.

(d) There is no differentiating factor in relation to this specific issue.

(e) The conclusion that the SSNIP analysis carried out by Henry Ergas suggested a small increase by the Duke Eastern Gas Pipeline could be defeated by the Interconnect prices below the tariff prevailing for the Duke Eastern Gas Pipeline does not deal with the conditions facing the MSP. It is notable that the Tribunal in that context particularly focussed on the ability of the Interconnect to constrain a price increase by the Duke Eastern Gas Pipeline.

(f) Similarly, the capacity of the Interconnect is what is being examined relative to that of the Duke Eastern Gas Pipeline. In the case of the MSP there is no relevant comparator.

---

18 Australian Competition and Consumer Commission Final Decision: Access Arrangement proposed by Epic Energy South Australia Pty Ltd for the Moomba to Adelaide Pipeline System, September.

5.47 Thus, there are a number of basis upon which the Tribunal reached the views it did concerning the Duke Eastern Gas Pipeline which do not apply to the MSP. Indeed some of those factors, such as the power of AGL, operate precisely to the contrary effect in the context of the MSP.

5.48 The decision in the Duke Eastern Gas Pipeline matter reflects the fact that careful consideration needs to be given to the particular circumstances affecting the relevant pipeline and there is no a priori reason why an absence of coverage for the Duke Eastern Gas Pipeline would lead to a conclusion that there should be no coverage on the MSP. The reasons why it is appropriate for the MSP to be covered are set out in detail in the Council's Final Recommendation and are not repeated here.

6 Criterion (c)

6.1 Criterion (c) requires the decision maker to be satisfied that access (or increased access) to the Services provided by means of the Pipeline can be provided without undue risk to human health or safety.

6.2 While the Council notes that this criterion has been satisfied in every application for coverage or revocation, the Council considers it should be retained, to maintain consistency with Part IIIA.

7 Criterion (d)

Interpretation

7.1 Criterion (d) requires the Council to be satisfied that access (or increased access) to the Services provided by means of the Pipeline would not be contrary to the public interest.

Not an additional positive requirement

7.2 In the *Duke EGP decision*, the Tribunal clarified the interpretation of criterion (d) as follows:

> *... criterion (d) does not constitute an additional positive requirement which can be used to call into question the result obtained by the application of pars (a), (b) and (c) of the [coverage] criteria. Criterion (d) accepts the results derived from the application of pars (a), (b) and (c), but enquires whether there are any other matters which lead to the conclusion that coverage would be contrary to the public interest. (Duke EGP decision, paragraph 145)*

7.3 The Council adopts a broad view of the types of matters that may raise public interest considerations under criterion (d), including the overall costs of regulation, and any effects that regulated access might have on the environment, regional development, and equity.

7.4 As a matter of interpretation, the Council considers that proper structure to be imposed upon clause (d) is that:

(a) if the public benefits exceed the public detriments, then criterion (d) is met;

(b) if the public benefits and public detriments are evenly balanced, then criterion (d) is met; and

(c) if the public detriment exceeds the public benefit, then criterion (d) is not met.

7.5 The passage by the Tribunal in *Duke EGP* set out above supports the view that criterion (d) requires the demonstration of a public detriment

before criterion (d) will not be satisfied. Criterion (d) is expressed as a negative criterion. The Minister may not decide that a pipeline is covered unless he or she is satisfied that access would not be contrary to the public interest. The passage from the *Duke EGP* decision expresses the question as whether there are any matters which lead to a conclusion that coverage would be contrary to the public interest. There must be some demonstration of public detriments exceeding the public benefits. Merely demonstrating that public detriments exist, which may be more or less equal to the public benefits, does not answer the question as posed in the *Duke EGP* decision.[19]

Costs of regulation

7.6 The Council has consistently recognised the fact that regulation has costs and inefficiencies. Direct costs of regulation might include the pipeline owner's costs of preparing access arrangements and the regulator's costs of assessing compliance with the Gas Code. There is also a risk of regulatory error, or the perception of it, given that regulated access pricing is a complex and contentious area.

7.7 The Council notes that some of the costs commonly associated with regulation may be incurred in any case; for example, settling terms and conditions of access with third party shippers.

7.8 Indirect costs might include reduced incentives to invest in pipeline infrastructure or reduced incentives to innovate or provide flexible services.

7.9 The indirect costs of regulation may be lower in the context of the National Gas Code than for more prescriptive access regimes. As

---

19 This approach was adopted in *Re Mt Thorley Operations Enterprise Agreement* 1996 (No 2) (1999) 94 IR 57 where the phrase "not contrary to the public interest" was considered in the context of a workplace relations dispute. Section 170MH(3) of the *Workplace Relations Act* 1996 (Cth) provides that, after satisfying other criteria, the Commission must terminate an agreement if it considers that it is not contrary to the public interest. In considering the issue, Boulton J of the Australian Industrial Relations Commission concluded:
"*Having regard to all the material before the Commission ... it cannot be concluded that it would be contrary to public interest to terminate the Agreement. Accordingly the Commission is obliged under s 170MH(3) of the Act to terminate the Agreement*." (at 66)

recognised by Ordover and Lehr (at p.21), the pricing mechanisms within the National Gas Code lessen the standard concerns about inefficiencies that may result from regulatory pricing rigidities. This is because the National Gas Code does not restrict the ability of parties to negotiate away from regulated reference tariffs.

7.10 In addition, the costs of regulation need to be viewed in relation to the likely benefits of regulating access to a particular service. The benefits of regulating access flow from the restraint of monopoly pricing. Access regulation can make upstream and downstream industries more viable, reduce delivered gas prices to consumers and reduce the need for unnecessary investment in alternative facilities. In its submission to the Council concerning the MSP application, Santos, for example, drew the Council's attention to the "public interest benefits of lower access prices and more efficient use of resources" (Santos 2001, sub.4, p.2).

7.11 The Council therefore considers that criterion (d) requires the decision makers to have regard to the costs and benefits of regulation.

7.12 The consideration of the costs of regulation is not limited to consideration of the financial costs of regulation. Another cost of regulation is the risk of regulatory failure, that is, the risk of error in balancing the competing interests of ensuring that the service provider earns a sufficient return on investment to attract capital investment whilst avoiding the service provider securing excessive returns. While it may not be possible to quantify this risk, it is a cost which is also a relevant consideration under criterion (d).

Other considerations under criterion (d)

7.13 The Council considers that the public interest is a very broad criterion which enables a range of factors to be taken into account and which is not confined in its scope to an assessment of the costs and benefits of competition. The breadth of the scope of the public interest criterion is well illustrated by the Tribunal's decision, in the authorisation context, in *Re Media Council of Australia (No 2) (1987) ATPR 40-774* at 48,436 - 48,442. In that case, the Tribunal explicitly found that the concept of public interest extended to take into account matters such as the appropriate content of advertising materials. Similarly, in *Re 7-Eleven Stores Pty Ltd & Ors* (1998) ATPR 41-666 the Tribunal described the

public benefit as "*anything of value to the community generally*" (at 41,479).

7.14 The prospect and consequences of asymmetrical regulation may also be a relevant consideration under criterion (d). In the MSP applications, a number of submissions were made concerning the consequences of asymmetrical regulation of the MSP and the Duke Eastern Gas Pipeline. The Council does not consider it contrary to the public interest to regulate pipelines that are able to exercise substantial market power while not regulating pipelines without market power. This outcome is clearly the intention of the National Gas Code; as evidenced by the inclusion of coverage criteria that use the existence of market power as a major determinant. However, the Council considers each application for coverage or revocation on its merits. Where pipelines possess similar characteristics, it is reasonable to expect that consistent application of the coverage criteria would result in the same coverage or revocation outcome in respect of each pipeline. However, where there are significant differences between pipelines, a consistent application of the coverage criteria might result in different coverage outcomes.

Residual discretion

7.15 The Council clearly has a residual discretion even if satisfied of the criterion (*Sydney Airport decision*, para 223) — the nature of that discretion is, however, limited. The *Sydney Airport* decision and the *Duke EGP* decision suggest that the residual discretion is only available for consideration of matters which do not fall within the criteria specified. In the *Sydney Airport decision*, the Tribunal stated that:

> *The Tribunal is prepared to accept that the statutory scheme is such that it does have a residual discretion. However, when one has regard to the nature and content of the specific matters in respect of which the Tribunal must be satisfied pursuant to s 44H(4) of the Act, that discretion is extremely limited. The matters therein specified cover such a range of considerations that the Tribunal considers there is little room left for an exercise of discretion if it be satisfied of all the matters set out in s 44H(4).*

7.16 However, the Tribunal then went on to examine the arguments which were put in the context of the residual discretion, each of which was an argument which had been raised in the context of the other criteria.

Whilst, it is not clear how that detailed consideration of the specific issues sits with the general position of principle which the Tribunal articulated, it may be that the Tribunal addressed each of the arguments in order to demonstrate that they were arguments which had otherwise been considered.

7.17 If the residual discretion did enable the Council to consider matters relevant to the other criteria, that would not be limited to criterion (d) and the Council would be faced with attempts to reopen each of the criterion under the residual discretion.

7.18 The Council considers that the better view is that the residual discretion afforded to the Council does not enable any reconsideration of matters already covered by criteria (a) to (d). Rather, the residual discretion examines whether there are any other circumstances or factors, which would cause the Council not to make a recommendation of declaration.

8 Process issues

8.1 The Issues Paper raises a number of issues concerning the current processes followed in making coverage or revocation decisions and the institutional arrangements under which those decisions are made. In particular, the Issues Paper asks the following questions:

(a) Are current and proposed institutional and governance arrangements appropriate?

(b) Do you think the current institutional arrangements are appropriate? If not, why not and what can be done to improve them?

8.2 The Council proposes a fundamental change to those arrangements. The Council proposes that it make the final decisions on coverage matters, retaining a merits review of that decision by the Australian Competition Tribunal. However, the material to which the Tribunal may have regard in such a review should be limited to the application, submissions and any other material which was before the Council when it made its decision.

Onus of Council and decision maker

8.3 Currently, the process by which coverage decisions are made is as follows:

(a) a person applies to the Council in accordance with section 1.3 of the Gas Code;

(b) the Council publishes the application and calls for submissions from interested parties in accordance with section 1.4 of the Gas Code;

(c) the Council publishes a draft recommendation in accordance with section 1.6 of the Gas Code;

(d) the Council makes a final recommendation to the Minister in accordance with section 1.7 of the Gas Code;

(e) in forming its final recommendation, the Council must consider any submissions received from the applicant or other interested parties in accordance with section 1.8 of the Gas Code;

(f) the Minister makes the final coverage or revocation decision in accordance with section 1.13 of the Gas Code.

8.4 A similar process applies for revocation decisions (see sections 1.24-1.34 of the Gas Code).

8.5 The Minister is required, under section 1.15 of the Gas Code, to decide the pipeline is covered (or decide not to revoke coverage) if the Minister is satisfied of each of the criterion of coverage (or revocation) set out in section 1.9 of the Gas Code, in precisely the same manner as the Council is required to be satisfied of those matters. However, the Council notes that there has been a considerable divergence of approaches adopted by different Ministers. For example, while the Gas Code requires the Minister to be satisfied of each of the criterion established for coverage (or revocation) under the Gas Code, there appears to be different levels of consideration adopted by different Ministers in order to satisfy themselves. Some Ministers appear to be satisfied provided the Minister is satisfied that the Council has followed proper processes and considered all submissions before it. Other Ministers prefer to consider the issues themselves in great detail in order to be satisfied. Some Ministers appear to accept submissions and material that was not before the Council, while other Ministers appear only to consider the information before the Council at the time it made its recommendation..

8.6 This lack of uniformity in approaches being taken by Ministers means that parties dealing with the relevant Ministers often have little or no understanding of how the Minister will approach the issue. This may result in considerable uncertainty amongst interested parties and significant delay.[20]

8.7 The Minister performs precisely the same role as the Council. Sections 1.14 and 1.35 of the Gas Code give the relevant Minister power to require the Council to provide such information, reports and other

---

[20] For example, on 14 November 2002, the Council recommended to the Hon. Ian Macfarlane MP, Minister for Industry, Tourism and Resources, the coverage of the Moomba to Sydney pipeline not be revoked. Some 9 months later, the Minister is still yet to issue his final decision on the matter.

assistance as the relevant Minister considers appropriate for the purpose of considering the application. The Council questions the benefits of such duplication of process, particularly in light of the delays that can arise.

8.8 Coverage decisions involve identifying natural monopoly infrastructure and analysing current and prospective competitive conditions in relevant markets. The appropriate body to make those decisions is a regulatory body with the necessary expertise.

8.9 The Council therefore proposes that the Minister be removed from the coverage process. Rather, the Council proposes that the Council's final recommendation become the decision, which decision would continue to be reviewable by the Australian Competition Tribunal (with some amendments to that process as outlined below). The Council recognises the importance of public policy considerations in this process. However, these public policy considerations should be (and are) reflected in the statutory test for coverage. The role of Government is to take into account the public policy considerations in formulating the statutory test to be applied. The Tribunal can then review the application of the statutory test through a merits review of the Council's decision.

Limited merits review for coverage decisions

8.10 The Council also considers that the mechanism by which coverage decisions are reviewed by the Australian Competition Tribunal requires amendment, again to avoid delay and unnecessary use of resources in the coverage decision-making process.

8.11 Currently, any review by the Tribunal of the Minister's decision on whether to cover a pipeline or to revoke coverage of a pipeline is a full merits review of that decision. This gives parties the opportunity to engage in regulatory gaming, for example, putting material before the Tribunal which was not before the Council or the Minister when the final recommendation and decision were made, resulting in further delays in the coverage or revocation process.

8.12 The Council considers that the review by the Tribunal should remain a merits review. However, the material which the Tribunal may consider should be limited to a review of the decision on the basis of the material

before the Council and the Minister (including the application and submissions of interested persons).

Timing

8.13 The Issues Paper asks "How timely are decisions made under the Gas Code? Do you think the process is unnecessarily protracted? If so, what has caused this and what do you think could be done to improve it?"

8.14 The Gas Code is quite prescriptive in the time 'limits' it sets for the determination of coverage issues. The following time limits are established by the Gas Code:

(a) when the Council receives an application that a particular pipeline be covered (or revoked), it must (provided it considers that the application is not based on trivial or vexatious grounds) within 14 days after receipt of the application, inform the service provider and other interested parties. The Council must also publish a notice in a national daily paper which describes the application and requests submissions within 21 days after the date of the notice (sections 1.4 and 1.26);

(b) between 21 days and 35 days after the day on which the notice is published, the Council must prepare a draft recommendation on the application (sections 1.6 and 1.28);

(c) between 14 and 28 days after the day on which its draft recommendation became publicly available, the Council must submit a recommendation to the relevant Minister that the pipeline be covered, or that the pipeline not be covered (section 1.7); or that coverage be revoked, or not revoked (section 1.29)

8.15 However, despite these time limits being specified in the Gas Code, the Gas Code also provides for a degree of flexibility. Section 7.16 of the Gas Code provides:

> *"If any section of this Gas Code requires the Council or the Relevant Minister to do something within a certain period, the Council or the Relevant Minister, as the case may be, may, in a particular case, increase the period it has to do the thing in question by the period originally specified in the section of the Gas Code concerned."*

8.16 Section 7.17 of the Gas Code provides that the Council or the Relevant Minister may only increase the period provided it publishes in a national newspaper notice of its decision to increase the period before the day on which the Gas Code would have required the thing to be done.

8.17 Section 7.18 of the Gas Code provides that the Council and the Relevant Minister may increase the period it has to do a thing any number of times provided it complies with the publishing of a notice as required in section 7.17.

8.18 The Council believes that the Gas Code strikes the correct balance between timing guidelines and flexibility and does not propose any amendments to this aspect of the Gas Code.

9 Role of regulator

9.1 The Issues Paper asks:

(a) Do the current arrangements for determining reference tariffs lead to inconsistencies and create an unnecessary level of uncertainty for pipeline owners/operators, particularly given the discretion provided to regulators?

(b) Do you think that the creation of a national energy regulator would address these problems?

Regulation is a separate issue from coverage

9.2 The Council believes it is important for the Commission, in assessing the effectiveness of the Gas Access Regime, to draw a clear distinction between "coverage" issues and "regulation" issues. By their very nature, coverage decisions involve different questions, information and skills compared to the consideration, analysis and arbitration of access disputes and the regulation of access.

9.3 Coverage decisions are concerned with the broad policy issues such as identifying natural monopoly infrastructure and analysing current and prospective competitive conditions in relevant markets discussed in above. Conversely, arbitration and regulation focus specifically on the regulated infrastructure. They involve analysis of specific access prices and underlying costs, asset valuations, depreciation, rates of return and prices as well as a range of requirements for the actual provision of third party access. (NCC 2001b, p. 55)

9.4 This two stage process is the approach to access regulation adopted in the Competition Principles Agreement, largely following the recommendations of the Hilmer Review. First, the identification of infrastructure which may be made subject to access rules. Second, a mechanism for the determination of those access rules. In relation to the second stage a negotiate/arbitrate model was adopted. Under Part IIIA of the TPA once a service has been declared a person requesting access negotiates an access agreement with the provider of the service. If there

is a dispute as to any aspect of access, the ACCC arbitrates the dispute (s.44S).[21]

9.5 The Gas Code is based upon the same two stage process of coverage and determination of terms and conditions of access. As in the case of Part IIIA, the second stage is fundamentally a process of negotiation and arbitration. This is reflected in the introductory words to Section 2 of the Gas Code which states:

> *"Where a Pipeline is covered, this section of the Gas Code requires a Service Provider to establish an Access Arrangement to the satisfaction of the Relevant Regulator for that Covered Pipeline. An Access Arrangement is a statement of the policies and the basic terms and conditions which apply to third party access to a Covered Pipeline. The Service Provider and a User or Prospective User are free to agree to terms and conditions that differ from the Access Arrangement (with the exception of the Queuing Policy). If an access dispute arises, however, and is referred to the Relevant Regulator, the Relevant Regulator (or any other arbitrator it appoints) must apply the provisions of the Access Arrangement in resolving the dispute"*

9.6 The mechanism for access under the Gas Code therefore encourages commercial negotiation but provides for arbitrated outcomes consistent with the approved Access Arrangement in the event of a dispute. There is nothing to prevent parties from reaching a commercial agreement outside the terms of any approved Access Arrangement. What the Gas Code does is to provide a common and transparent fall back position for any arbitrated outcome of a Reference Service. Thus, the Second Reaching Speech to the Gas Pipelines Access (South Australia) Bill states:

> *The National Access Gas Code is designed to provide a degree of certainty as to the terms and conditions of access to the services of specific gas infrastructure facilities, but to preserve the role of commercial negotiation.*[22]

9.7 The primacy accorded to commercial negotiations is reinforced by Section 2.50 of the Gas Code which states:

---

21 *Rail Access Corporation v. New South Wales Minerals Council Limited* (1998) 87 FCR 517 at 519.

22 Hansard, Tuesday 2 December, 1997 at page 18.

For the avoidance of doubt, nothing (except for the Queuing Policy) contained in an Access Arrangement (including the description of Services Policy) limits:

(a) the Services of Service Provider can agree to provide to a User or Prospective User;

(b) the Services which can be the subject of a dispute under Section 6;

(c) the terms and conditions a Service Provider can agree with a User or Prospective User; or

(d) the terms and conditions which can be the subject of a dispute under Section 6.

9.8 The aim of the Gas Code in this regard is identified in the introductory material as being:

To provide sufficient prescription so as to reduce substantially the number of likely arbitrations, while at the same time, incorporating enough flexibility for the parties to negotiate contracts within an appropriate framework.[23]

9.9 This is also reflected in the introductory words to Section 6 of the Gas Code which deals with dispute resolution. The introductory words provide:

The Gas Code does not limit the ability of the Service Provider and User to reach an agreement about access without recourse to these dispute resolution procedures. The Gas Code also does not limit the terms and conditions on which a service provider and User can reach agreement. In particular, parties can agree to a Tariff other than the References Tariff. The provisions in Section 6 will apply only if parties cannot reach agreement and the dispute is notified to the Relevant Regulator.

9.10 In an access dispute arising under the Gas Code, the arbitrator is required to apply the provision of the Access Arrangement for the

---

[23] These introductory words to the Gas Code do not form part of the Gas Code nor does the Overview at the beginning of each section of the Gas Code. However, consideration is to be given to the introduction and the Overview to confirm that a meaning of a provision if the ordinary meaning conveyed by the text of the provision or to determine the meaning when the provision is ambiguous or obscure or the ordinary meaning conveyed by the text of the provision leads for a result that is manifestly absurd or unreasonable: Sections 10.4 and 10.5 of the Gas Code.

Covered Pipeline concerned, subject to paragraphs (b), (c) and (d) of section 6.18. In addition he must take into account the matters set out in section 6.15. Section 6.18 prohibits the arbitrator from making a decision that:

(a) subject to paragraphs (b), (c) and (d) is inconsistent with the Access Arrangement;

(b) would impede the existing right of a User to obtain Services;

(c) 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;

(d) is inconsistent with the applicable Queuing Policy; or

(e) requires the Service Provider to provide, or the User or Prospective User to accept, a Reference Tariff at a Tariff other than the Reference Tariff.

9.11 Whilst coverage under the Gas Code does import an obligation to provide Access Arrangements in relation to some Services, its structure and operation is not fundamentally different from that contained in Part IIIA of the TPA.

Relevant regulator

9.12 The Commission in its Review of the National Access Regime has recently considered the issue of whether different regulators should be responsible for coverage and regulatory issues.

9.13 In its Position Paper, the Commission acknowledged the validity of the separation between responsibility for "policy making" - the broad coverage decision - and administration of Part IIIA's detailed regulatory requirements. It observed that, especially where considerable judgment is involved in decisions about whether a regulation should apply in a particular case, the argument for separation of responsibilities was strong. (PC 2001, p. 380) However, the Commission also noted that the degree of judgment involved in coverage decisions under Part IIIA is significantly limited and cited a number of cost issues which resulted in its conclusion that there was a case for making a single body responsible

for administering Part IIIA. On balance, the Commission considered that this single body should be the ACCC. (PC 2001, p. 381)

9.14 In response to the Position Paper, the Council drew attention to the considerable benefits in maintaining the current institutional separation. Those benefits include:

(a) preserving the importance of coverage processes;

(b) greater transparency;

(c) avoiding the risk of conflict or perceptions of conflict; and

(d) the development of distinct expertise in policy processes and regulatory processes respectively. (PC 2001a, p. 58)

9.15 The Council submitted that it was important to maintain a distinction between regulatory and coverage issues and the regulators responsible for them. The Council noted that the specialisation required to address coverage and regulation issues results in the:

> *development of expertise and removes the risk of coverage questions being 'caught up' in specific questions of regulatory intervention. The division that flows from this framework provides greater transparency of process and decision making.* (PC 2001a, p. 55)

9.16 Continuing its objection to any merging of the two processes the Council stated:

> *Independent and distinct processes are essential to the effective operation of the coverage test. There is a danger that if the regulator also makes the coverage decision, participants - especially service providers - may feel unable to contest the applications to the same degree for fear of alienating the potential future arbitrator.*
>
> *Further, there is a danger that a regulator may be perceived as having the particular mind-set that inevitably leads to regulation or disinclined to appropriate testing for continued coverage. Such perceptions are plausible because of the essential conflict between the roles of coverage and regulation of terms and conditions post coverage. (PC 2001a, p. 56)*

9.17 As noted by the Council in its submission, the only way any combination of roles in a single organisation could be effectively maintained, would require the organisation to ring fence the coverage role from the

regulatory role. The Council considers that the degree of ring fencing required would negate any possible benefits of combining the roles. (PC 2001a, p. 56)

9.18 After considering the submissions in response to its Position Paper, the Commission ultimately decided that "the costs of making the ACCC solely responsible for administering Part IIIA would almost certainly outweigh the benefits", and therefore concluded that:

> *the current division of administrative responsibility in Part IIIA between the National Competition Council and the Australian Competition and Consumer Commission is appropriate.* (PC 2001, p. 386, finding 14.2)

9.19 Consistent with its submission to the Commission in the context of the Review of the National Access Regime, the Council submits that any submissions to amend to the Gas Access Regime to blur the distinction between coverage and regulation issues and their regulation, such as combining coverage and regulatory roles in a single organisation, risks losing the separateness of those processes and should therefore be rejected by the Commission.

National uniformity

9.20 The Council of Australian Governments Energy Market Review Report - *Towards a truly national and efficient energy market* (Parer report) considered the regulatory arrangements currently in place in the energy market. The report recommended that a new statutory body be formed, called the National Energy Regulator, to be the independent energy regulator in all jurisdictions, interconnected or otherwise. It was proposed that the National Energy Regulator would encompass the current roles of the NECA and the energy specific roles of the ACCC and State regulators. The aim of this recommendation was to create a regulator accountable under legislation to all Australian governments, with strongly defined independence and a national focus. (CoAG 2002, p. 84)

9.21 While the Council supports a single national regulator to make regulation decisions, the Council disagrees with one key aspect of the Parer report's recommendation. Relevant to the Gas Access Regime, in

its recommendation the report proposed that the key roles of the national energy regulator would be to:

(a) approve Gas Code changes under the Gas Code;

(b) decide on pipeline coverage under the Gas Code;

(c) administer the transmission access regulation that is currently dealt with by the ACCC and the Western Australian regulator;

(d) administer distribution access regulations that are currently dealt with by state/territory regulators (and the ACCC in the Northern Territory).

9.22 As discussed above, the Council does not support the amalgamation of coverage and regulatory responsibilities under one body. The Council submits that the National Energy Regulator should be responsible for all regulatory issues on a national basis, but that responsibility for coverage issues should be retained by the Council for the reasons discussed above. However, the Council recognises that the National Energy Regulator may have the responsibility to decide on coverage under the Gas Code. If this is the case, strict ring fencing arrangements would need to be established between the arm of that Regulator concerned with making coverage decisions and the arm concerned with making regulatory decisions.

9.23 Subject to this restriction, the Council endorses the comments made in the Parer report, that:

> *"The creation of a single National Energy Regulator, by amalgamating all the current jurisdictional regulators, will significantly reduce regulatory costs - particularly for companies operating in more than one jurisdiction. It will also deliver greater uniformity in regulatory decision making and interpretation of Gas Code provisions. This makes for more predictable regulatory outcomes and hence reduces risk."*(CoAG 2002, p. 215)

9.24 As noted by the Commission in its Issues Paper, the Ministerial Council on Energy agreed in June 2003, subject to consideration by each jurisdiction, to establish a National Energy Regulator to oversee transmission and wholesale of gas. Subject to the Council's recommendation that jurisdiction over coverage issues be retained by a

separate entity, the Council welcomes the Ministerial Council on Energy's endorsement of the Parer report's recommendation.

Certainty

9.25 One of the consequences of the Epic decision[24] is that regulators under the Gas Code have a broad discretion and flexibility in consideration of regulatory issues. However, an unfortunate consequence of this flexibility in discretion is that there may be a lack of certainty as to the matters a regulator will take into account, and the weight that will be given by regulator to competing considerations. This problem will be somewhat addressed by the inclusion of a clear object provision in the Gas Code and the Gas Pipelines Access Acts and by the establishment of a national regulator. These issues are dealt with in section 2 of this submission.

9.26 The Epic decision raised a particular issue concerning the relevance of the purchase price paid by a service provided for a covered pipeline for the purposes of determining the reference tariff for that pipeline in an access arrangement under the Gas Code. As a preliminary matter, the Council notes the historic nature of this question in the context of the Dampier to Bunbury pipeline and queries whether an issue of this nature is likely to arise again in relation to other pipelines.

9.27 The Epic decision has established that the purchase price is a matter which the regulator must take into account for the purposes of regulation under the Gas Code. This raises the question of whether the Gas Code should be amended to include established rules that prescribe all matters to which the regulator is required to have regard, or whether the Gas Code should leave flexibility with the decision maker. The Council believes that the regulator should continue to have a discretion to determine the weight given to the purchase price (and other matters) in reaching regulatory decisions.

9.28 The Council considers that the introduction of a single, clear objects clause coupled with a requirement that the regulator have regard to that objects clause, together with the introduction of a single national

---

24 Re Dr Ken Michael AM; ex parte Epic Energy (WA) Nominees Pty Ltd & Anor [2002] WASCA 231).

regulator, will go some way to addressing the issues of uncertainty raised by the Epic decision.

10 Access regulation and new investment

Distinction between coverage issues and regulation issues for greenfields pipelines

10.1 The Issues Paper asks:

(a) What would be the advantages and disadvantages of amending the Gas Code to enable binding rulings on the coverage of pipelines prior to their construction?

(b) What would be the advantages and disadvantages of providing investors in a proposed transmission pipeline with the option of a 15 year (or some other fixed term) access holiday?

10.2 The regulation of greenfields investment in gas pipelines is a contentious issue. The Commission, in its Issues Paper, raises the issue of the interaction between access regulation and new investments. It is important, when considering those issues, to determine whether the issues that are raised in considering whether to grant an access holiday (or similar flexible regulatory approaches) are questions of coverage, or questions of appropriate regulation. As set out in paragraph 10.20, the Council considers that it is important to draw a distinction between these two issues.

10.3 The Council considers that some of the mechanisms proposed to foster efficient investment in gas pipelines raise coverage issues, while other proposed mechanisms raise purely regulatory issues. The Council will limit its comments to the importance of the distinction between coverage issues and regulatory issues and to mechanisms which fall within the "coverage" category.

Voluntary constraints

10.4 In the Duke EGP decision, the operators of the Duke Eastern Gas Pipeline gave a voluntary undertaking as to the terms upon which transportation services would be provided to third parties. A voluntary

undertaking mechanism may be a means of establishing the terms on which the pipeline will provide services to third parties. The Council does not comment on the effectiveness of such a mechanism.

10.5 However, the Council does note that it was argued in Duke EGP that a voluntary undertaking by the operator of that pipeline as to the terms upon which transportation services were provided to third parties was a factor which was relevant to consideration of criterion (a). The Council considers that the terms on which any pipeline volunteers to provide services to third parties is a relevant matter only to an assessment of market conditions for the purposes of criterion (a). Criterion (a) is concerned with neither the needs of a particular access seeker nor with the particular intentions or aspirations of a particular service provider. Coverage under the Gas Code is regulatory rather than punitive. What must be asked is: absent regulation:

(a) what would be the economic incentives and what would be the economic constraints that would operate on the provision of services by means of the pipeline; and

(b) what would be the resultant structural impact of those incentives and constraints on another market.

10.6 The fact that a service provider may seek to impose some voluntary constraint cannot be relied upon because, absent some regulatory mechanism, there is no mechanism for ensuring its consistent or ongoing application particularly in circumstances where the economic incentives may be for different behaviour.

Non-binding Rulings

10.7 Non-binding rulings are another mechanism which may be proposed as a solution to any uncertainty faced by a potential investor in gas pipelines as to whether their pipeline will be regulated and if so, on what terms.

10.8 There is currently a procedure for advanced advisory opinions under the Gas Code. The relevant provisions are as follows:

1.22 A Service Provider may request an opinion from the Council as to whether a proposed Pipeline would meet the criteria for coverage in section 1.9.

1.23 The Council may provide an opinion in response to a request under section 1.22 but the opinion does not bind the Council in relation to any subsequent application for Coverage of the Pipeline.

10.9 To date, only one application for an advanced ruling has been made to the Council. In that case, the Council's advice was that, on the basis of the information supplied by the prospective service provider, it was unlikely that the pipeline would become covered.

10.10 Under the Gas Code, the advanced ruling is not binding on the Council, and as a result it is more appropriately described as an advisory opinion. The Council considers such opinions are likely to have little influence in investment decisions.

Binding Rulings

10.11 Binding rulings are a mechanism which the Council would support in principle to provide investors with some level of certainty as to whether their proposed pipeline will be covered by the Gas Code.

10.12 The Council has previously commented:

> *"if the issues relate to whether the provider of a marginal product would have market power in the downstream market, or whether the cost of regulation of a particular service might be too high and contrary to the public interest, they would appear to go to the criteria for coverage. If this were the case, arguably they would be best dealt with through a binding ruling approach."* (NCC 2001a, p. 18)

10.13 The Council notes the discussion in the Issues Paper regarding questions about appropriate returns on investment. The Council regards such questions in natural monopoly infrastructure as being regulatory in nature, rather than coverage questions. The binding ruling approach is not appropriate to such questions.

10.14 The Council believes that a mechanism for binding advance rulings on the prospects of coverage has some merit. The Council sees the binding ruling process having particular application in situations where:

(a) it is unlikely that the infrastructure will have natural monopoly characteristics and, as a consequence, it is unlikely that criterion (b) will be satisfied; or

(b) the market conditions are such that it is unlikely that criterion (a) will be satisfied, for example, because the infrastructure owner is not ever likely to possess market powers.(NCC 2001a, p. 20)

10.15 The Council submits that the fundamental advantage of a binding ruling is that it involves consideration of the relevant issues at the time the investment is made. Even if the Council were unable to reach a firm view on one of the criteria, the process and views reached in relation to the other criteria may nonetheless provide a much greater degree of certainty to a pipeline owner than would otherwise be available. Given the levels of concern and recent complaint about levels of uncertainty in pipeline investment, any mechanism that promotes certainty is likely to be efficiency enhancing. (NCC 2001, p. 21)

10.16 However, as the Council noted in its submission to the Commission's Review of the National Access Regime, there would be difficult issues to consider. Primarily, these issues would revolve around the extent to which the Council - or any other body charged with the task - would be in a position to form an opinion on relevant matters. This would necessarily depend on the circumstances of each application and the information provided to that body.(NCC 2001a, p. 19)

10.17 The Council considers that it would be appropriate for any binding ruling process to be conducted in a similar way to an application for coverage. It might include a process for the Council to recommend revocation of the binding ruling if there was a material change in circumstances or if the service provider purposively or negligently misled the Council in the information provided, although such a process would need to include appropriate provisions identifying the persons who could apply for such a recommendation and the party which bears the burden of proof in such circumstances. The Council is also of the opinion that any such revocation should be subject to a merits review to the Tribunal, consistent with the proposed amendments to the review process set out in section 7 above. (NCC 2001, p. 20)

10.18 The Parer report proposed introducing, amongst other things, binding up front coverage rulings. The report noted that the current provisions of the Gas Code, where parties can seek an *opinion* from the Council,

create "significant uncertainty for prospective pipeline companies regarding the potential for them to be covered (and hence regulated)."(CoAG 2002, p. 210) While not agreeing with the Council's recommendation that it should be empowered to revoke a binding ruling if there were a material change in circumstances, the report concluded that binding up font coverage rulings would be useful in reducing regulatory uncertainty, and that the Gas Code should be amended to enable the granting of binding coverage rulings. (CoAG 2002, p. 211)

10.19 The Council considers that a period of 15 years may be too long a time period for binding rulings to remain in force. The Council considers that any binding ruling process must provide the Council with flexibility to determine the period during which any particular binding ruling would remain in force.

Access Holidays

10.20 The Parer report also considered, and recommended, the introduction of 15 year economic regulation free periods for new transmission pipelines. In its discussion, the report states:

> *"The arguments in support of economic regulation for new transmission pipelines may not be as strong as for established pipelines. Typically a proposed transmission pipeline is seeking to respond to a market demand. ... In such circumstances, the prospective initial users of the pipeline ('foundation users') have a significant degree of countervailing power - such that if a pipeline company seeks to charge them excessive tariffs, they can approach another pipeline company to build the pipeline for them. As such, any transportation agreement reached between the pipeline company and users prior to the construction of the pipeline should be reasonable for both users - so long as there are no control issues arising from vertical ownership.*
>
> ...
>
> *In the Panel's view, the solution is that prospective transmission pipeline companies should have the ability to choose to not have any price regulation imposed upon the new pipeline for the first fifteen years of its operation. Pipeline companies choosing this option would be free to negotiate with customers and enter into transportation contracts."* (CoAG 2002, pp. 211-212)

10.21 The Parer report also recommended some requirements for new pipelines before they would qualify for the option of no price regulation. These conditions are that the pipeline must:

(a) be a new transmission pipeline;

(b) have sufficient vertical separation of ownership;

(c) publish tariffs for access to the pipeline; and

(d) provide for all capacity to be fully tradeable. (CoAG 2002, p. 213)

10.22 The Council does not support the concept of access holidays. However, it considers that if access holidays were to be introduced a number of issues would need to be addressed, including the difficulty in identifying relevant investments and the risk of gaming by infrastructure owners. The trigger to activate an access holiday and the principles by which the duration of the access holiday would be determined would also need to be clearly identified. (NCC 2001a, pp. 17-18)

10.23 The Council would be concerned if the determination of whether an access holiday would be available were based on an *ex ante* assessment of profitability of any particular project. For example, if a project was likely to earn normal returns (which should be determined taking into account regulatory risk), it could indicate that market power could not be exercised in a dependent market; in which case, coverage would not be appropriate. Conversely, if high returns are doubtful because a project is not efficient, it is unclear why favoured treatment is warranted. (NCC 2001a, p. 18)

Current treatment under Gas Code

10.24 The Council notes that the Gas Code contains flexibility to enable the ACCC to factor in the unique risks associated with greenfields investments through the regulatory process. For example, the ACCC considered greenfields issues in its decision on the Central West Pipeline Assess Arrangement and has also developed greenfields guidelines, to assist prospective pipeline developers, investors, financiers, consultants and users in the gas industry understand the regulation of new natural gas transmission pipelines. Similarly, the Council took account of greenfields issues in its approach to the NT/SA

Rail certification under Part IIIA. The option of enabling an independent regulator to factor in the unique risks associated with greenfields investments through the regulatory process was canvassed in submissions by Network Economics Consulting Group Pty Ltd, Telstra and AusCid to the Commission for its review of the National Access Regime. The Council remains of the view that these proposals have some merit and may provide a workable solution within the current legislative framework.(NCC 2001a, p. 41)

Foundation contracts

10.25 The Council notes that the Gas Code in its current form does not appear to apply to foundation contracts entered into by the service provider of a new, uncovered pipeline, particularly where those contracts are entered into prior to construction of the relevant pipeline. The introduction to section 6 of the Gas Code states:

> *"Because the Arbitrator cannot deprive a person of a contractual right 'foundation shippers' contracts cannot be overturned by the arbitrator at either the Service Provider's or foundation shipper's request".*

10.26 There is no provision in the Gas Code that empowers the relevant regulator to "open up" and vary the terms of a foundation contract.

10.27 The Gas Code recognizes the primacy of existing contractual rights in the arbitration provisions set out in section 6 of the Gas Code. The Arbitrator cannot make a decision that would:

(a) deprive a person of any contractual right that existed prior to the notification of the dispute, other than an Exclusivity Right (that is, 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) which arose on or after 30 March 1995;

(b) impede the existing right of a User to obtain Services.

10.28 The arbitration mechanism can only be triggered by a Prospective User or a Service Provider where the Prospective User and Service Provider are unable to agree on one or more aspects of access to a Service. A

"Prospective User" is defined as "a person who seeks or is reasonably likely to seek to enter into a contact for a Service and includes a User who seeks or may seek to enter into a contact for an additional Service". The arbitration procedure therefore cannot be triggered by a foundation shipper in relation to disputes arising from their foundation contract with the Service Provider.

Provision of information to access seekers

10.29 The Issues Paper asks: do the information gathering requirements of the Gas Code significantly hinder investment? If so, what changes would ensure an appropriate balance between the interests of access seekers and providers, while not significantly discouraging infrastructure investment?

10.30 As noted by the Commission in its Issues Paper, section 5 of the Gas Code provides that service providers are required to provide information to prospective users. The Gas Code requires service providers to supply information sufficient for access seekers to understand how the terms and conditions of access, especially the tariff, have been derived. In general, information must be provided in the following categories:

(a) access and pricing principles;

(b) capital costs;

(c) operations and maintenance;

(d) overheads and marketing costs;

(e) system capacity and volume assumptions; and

(f) key industry performance indicators used by the service provider. (NCC 2001a, p. 41)

10.31 The Council considers that it is essential that the information set out in the Gas Code be provided to access seekers in order to facilitate commercial negotiation of the terms on which the service provider will provide transportation services to a third party. The Council recognises that the Gas Code is relatively prescriptive in specifying the type of information that should be made available to access seekers. While in

its submission to the Commission's Review of the National Access Regime, the Council considers that it is appropriate within a general regime such as Part IIIA, to limit information requirements to broad categories, in the context of the Gas Access Regime, the Council considers that the prescription of information currently contained in the Gas Code is necessary and appropriate in an industry-specific access scheme, where it is possible to prescribe the particular categories of information that an access seeker is likely to require in order to negotiate the terms of access consistently with the negotiate/arbitrate model adopted by the Gas Code.

References

CoAG (Council of Australian Governments) 2002, *Towards a truly national and efficient energy market*, Final Report of the Council of Australian Governments' Independent Review of Energy Market Directions, December, AusInfo, Canberra.

Hilmer Review (Independent Committee of Inquiry into National Competition Policy) 1993, *National Competition Policy*, AGPS, Canberra, August.

NCC (National Competition Council) 2003, *Draft Recommendation on the Application for Revocation of Coverage of the Goldfields Gas Pipeline*, September.

—— 2002, *Final Recommendations on applications for revocation of the MSP Mainline and the Canberra lateral*, November.

—— 2001a, *Review of the National Access Regime - Submission in response to the Productivity Commission's position paper*, July.

—— 2001b, *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.

Ordover J. and Lehr W. 2001, 'Should coverage of the Moomba-Sydney pipeline be revoked?', in National Competition Council, *Draft Recommendation on the Application for Revocation of the Moomba to Sydney Gas pipeline and the Dalton to Canberra lateral*, December 2001, http://www.ncc.gov.au/pdf/REGaMoRe-002.pdf.

PC (Productivity Commission) 2003, *Review of the Gas Access Regime – Issues Paper*, July.

—— 2001, *Review of the National Access Regime*, Report, no. 17, AusInfo, Canberra.

Appendix 1 – Summary of coverage and revocation applications under the National Gas Code

Applicant	*Pipeline*	*Decision sought*	*Council recommendation*	*Minister's decision/outcome*
Southern Cross Pipelines (March 1999)	Goldfields gas transmission pipeline to Keith power station (Western Australia)	Revocation	To revoke coverage (June 1999)	To revoke coverage (July 1999)
Southern Cross Pipelines (March 1999)	Goldfields gas transmission pipeline– Leinster power station (Western Australia)	Revocation	To revoke coverage (June 1999)	To revoke coverage (July 1999)
Southern Cross Pipelines (March 1999)	Kalgoorlie–Kambalda (Western Australia)	Revocation	Not to revoke coverage (June 1999)	Not to revoke coverage (July 1999)
Southern Cross Pipelines (March 1999)	Goldfields gas transmission pipeline to Kalgoorlie power station (Western Australia)	Revocation	To revoke coverage (June 1999)	To revoke coverage (July 1999)
SAGASCO South East (May 1999)	Tubridgi pipeline (Western Australia)	Revocation	Not to revoke coverage (July 1999)	Not to revoke coverage (August 1999)
Boral Energy Resources (May 1999)	Beharra Springs pipeline (Western Australia)	Revocation	To revoke coverage (July 1999)	To revoke coverage (August 1999)
Robe River Mining Company (June 1999)	Karratha–Cape Lambert pipeline (Western Australia)	Revocation	To revoke coverage (Sept 1999)	To revoke coverage (Sept 1999)
Epic Energy SA (December 1999)	South east pipeline system (South Australia)	Revocation	To revoke coverage (March 2000)	To revoke coverage (April 2000)

Applicant	*Pipeline*	*Decision sought*	*Council recommendation*	*Minister's decision/outcome*
AGL Energy Sales and Marketing (January 2000)	Eastern gas pipeline (Longford–Sydney)	Coverage	To cover (June 2000)	To cover (October 2000) AGL Energy Sales and Marketing applied to the Australian Competition Tribunal for a review of the Minister's decision. On 4 May 2001, the tribunal handed down its decision not to cover the pipeline.
Eastern Australian Pipeline Limited (now Australian Pipeline Trust) (April 2000)	Moomba–Sydney pipeline system (Moomba–Wilton trunk line)	Revocation	Not to revoke coverage (September 2000)	Not to revoke coverage (October 2000)
Eastern Australian Pipeline Limited (now Australian Pipeline Trust) (April 2000)	Young–Culcairn lateral (New South Wales)	Revocation	Not to revoke coverage (September 2000)	Not to revoke coverage (October 2000)
Eastern Australian Pipeline Limited (now Australian Pipeline Trust) (April 2000)	Dalton–Canberra lateral (New South Wales and the ACT)	Revocation	Not to revoke coverage (September 2000)	Not to revoke coverage (October 2000)
Envestra (April 2000)	Palm Valley–Alice Springs pipeline (Northern Territory)	Revocation	To revoke coverage (July 2000)	To revoke coverage (July 2000)
Envestra (April 2000)	Alice Springs distribution system (Northern Territory)	Revocation	To revoke coverage (July 2000)	To revoke coverage (July 2000)
Dalby Town Council (August 2000)	Dalby distribution network (Queensland)	Revocation	To revoke coverage (October 2000)	To revoke coverage (November 2000)
Peabody Moura Mining Pty Ltd (August 2000)	Peabody–Mitsui gas pipeline (Queensland)	Revocation	To revoke coverage (October 2000)	To revoke coverage (November 2000)
Oil Company of Australia (August 2000)	Kincora–Wallumbilla pipeline (Queensland)	Revocation	To revoke coverage (October 2000)	To revoke coverage (November 2000)
Oil Company of Australia (August 2000)	Dawson Valley pipeline (Queensland)	Revocation	To revoke coverage (October 2000)	To revoke coverage (November 2000)
Envestra Ltd (May 2001)	Mildura pipeline (South Australia and Victoria)	Revocation	To revoke coverage (August 2001)	To revoke coverage (September 2001)

Applicant	*Pipeline*	*Decision sought*	*Council recommendation*	*Minister's decision/outcome*
Envestra Ltd (May 2001)	Riverland pipeline (South Australia)	Revocation	To revoke coverage (August 2001)	To revoke coverage (September 2001)
Eastern Australian Pipeline Limited (now Australian Pipeline Trust) (June 2001)	Moomba–Sydney pipeline system (Moomba–Wilton trunk line)	Revocation	Not to revoke coverage (November 2002)	Being considered
Eastern Australian Pipeline Limited (now Australian Pipeline Trust) (June 2001)	Dalton–Canberra lateral (New South Wales and the ACT)	Revocation	Not to revoke coverage (November 2002)	Being considered
CMS Gas Transmission Australia (October 2001)	Parmelia pipeline (Western Australia)	Revocation	To revoke coverage (February 2002)	To revoke coverage (March 2002)
Roma Town Council (February 2002)	Roma distribution system (Queensland)	Revocation	To revoke coverage (April 2002)	To revoke coverage (May 2002)
Envestra Ltd (September 2002)	Mildura distribution system (Victoria)	Revocation	To revoke coverage (December 2002)	To revoke coverage (December 2002)
NT Gas Distribution Pty Ltd (January 2003)	City Gate–Berrimah pipeline (Northern Territory)	Revocation	To revoke coverage (April 2003)	To revoke coverage (May 2003)
Goldfields Gas Transmission Pty Ltd (March 2003)	Goldfields gas pipeline (Western Australia)	Revocation	Being considered. Draft recommendation not to revoke coverage (September 2003)	
Country Energy Pty Ltd (July 2003)	South West Slopes distribution network (New South Wales)	Revocation	To revoke coverage (September 2003)	Being considered
Country Energy Pty Ltd (July 2003)	Temora distribution system (New South Wales)	Revocation	To revoke coverage (September 2003)	Being considered