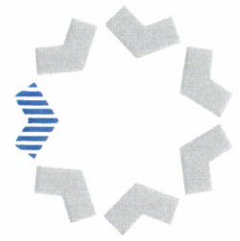


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3 February 2020

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Consultation RIS – Gas Pipeline Regulation Reform – supplementary submission

The NCC is grateful for the opportunity to make a supplementary submission to the COAG Consultation RIS.

The NCC provided an initial submission to the COAG Consultation RIS on 24 December 2019 in relation to governance arrangements under the NGL. This supplementary submission addresses the broader design of the gas regulatory regime; and should be read in conjunction with the 24 December 2019 submission.

If you would like to discuss this submission, please contact me on 03 9290 1993 or Richard.york@acc.gov.au

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Richard York', is written over a faint, larger version of the same signature.

Richard York
NCC Executive Director

NATIONAL
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COUNCIL



NCC supplementary
submission to COAG
Consultation RIS – Gas
Pipeline Regulation Reform

February 2020

Introduction

1. The National Competition Council (NCC) appreciates the opportunity to provide a supplementary submission to the Council of Australian Governments (COAG) Consultation Regulatory Impact Statement (Consultation RIS) on options to improve gas pipeline regulation.
2. The NCC provided an initial submission to the COAG Consultation RIS on 24 December 2019 in relation to governance arrangements under the NGL. This supplementary submission addresses the broader design of the gas regulatory regime; and should be read in conjunction with the 24 December 2019 submission.

Over-arching comments

3. The COAG Consultation RIS sets out four alternative policy options for reform of national gas pipeline regulation. Each of these options contains a “package” of reforms that covers issues relating to when pipelines should be regulated; what forms of regulation should be adopted; information disclosure requirements; and negotiation frameworks and dispute resolution mechanisms. The specific policies contained within each package of options are summarised in Table 2 of the Consultation RIS.
4. Developing a coherent and consistent set of policy reforms is a particularly difficult task, with specific policy reform options having the potential to alter incentives for different stakeholders; and change behaviours in ways that lead to unintended consequences. Ensuring a complete package of options does not contain individual policies that work against each other is also especially challenging.
5. The Council considers there are elements within each of the four packages that could contribute toward a coherent set of reform proposals. However, the Council does not favour any of the four proposed packages in their entirety. Specifically:
 - Option 1 (the status quo) retains a number of undesirable elements, including the potential for tension between existing regulations associated with light-handed regulation of covered pipelines under the National Gas Law (NGL) and Part 23 of the National Gas Rules (NGR) – see paras 22 – 25 below
 - Option 4 (requiring all pipelines be subject to requirements to provide access to gas pipelines on a non-discriminatory basis) is overly intrusive and risks over-regulation of gas pipelines without proper consideration being afforded to whether the costs of this particular form of regulation are outweighed by its benefits
 - Options 2 and 3 contain some desirable recommendations, but are packaged with other elements that the NCC considers generate outcomes likely to be inconsistent with the national gas objective (NGO). For instance, and as noted in our 24 December 2019 submission, both options contain undesirable governance arrangements whereby the designated regulator of gas pipeline services will be tasked with choosing which services are subject to regulation.
6. In this submission, the NCC has not sought to set out a complete policy proposal. However, it has sought, at a high-level, to identify certain key elements that it considers should be contained within any final reform proposal recommended by the COAG Energy Council. It does this by first setting out key over-riding objectives that it considers

should govern the choice of individual reform proposals; and then outlining specific proposals consistent with these objectives.

Two over-riding objectives for natural gas pipeline regulation

7. Since its inception in 1997, the regime (the then Gas Code) governing access to natural gas pipelines in Australia has evolved in response to various reviews, but always maintained broad consistency with the National Access Regime (NAR) set out in Part IIIA of the *Competition and Consumer Act 2010* (Cth).¹ Although aspects of the NAR have changed over time, the principles at the heart of the regime have endured.
8. The NAR was established following recommendations in 1993 by the Committee of Inquiry chaired by Professor Fred Hilmer (Hilmer Committee).² The Hilmer Committee's recommendations were directed to addressing the 'essential facilities problem': the economic problem created by a facility which could not be duplicated economically, and to which access was required by third parties in order to compete effectively in upstream or downstream markets.³
9. According to the Hilmer Committee:

An "essential facility" is, by definition, a monopoly, permitting the owner to reduce output and/or service and charge monopoly prices, to the detriment of users and the economy as a whole. In addition, where the owner of the facility is also competing in markets that are dependent on access to the facility, the owner can restrict access to the facility to eliminate or reduce competition in the dependent markets.⁴
10. Where an owner of an essential facility is not competing in dependent markets (i.e. is not vertically integrated), it may not have an incentive to deny access to a service. However, a non-integrated service provider may have the ability and incentive to charge monopoly prices that result in economic inefficiencies and welfare loss.⁵
11. In this regard, the NCC is also cognisant of the monopoly pricing problem that can exist for non-vertically integrated infrastructure service providers such as gas pipelines, ports, airports and railways.
12. These issues remain just as relevant today, as noted by the Productivity Commission (PC) in its 2013 report relating to the NAR.⁶ In its report, the PC determined that access regulation can be used to address an enduring lack of effective competition, due to natural monopoly, in markets for infrastructure services. There may be benefits from access regulation where infrastructure service providers have enduring market power

¹ The Gas Code was certified by the NCC as an effective access regime under Part IIIA of the (then) *Trade Practices Act* in 1997.

² Commonwealth of Australia, *National Competition Policy* (Hilmer Report), August 1993.

³ Hilmer Report, pp. 239ff. See also: Productivity Commission, *National Access Regime*, October 2013, p. 71; Productivity Commission, *Review of the Gas Access Regime*, June 2004, pp. 87-88.

⁴ Hilmer Report, *op. cit.*, pp. 239-240

⁵ Hilmer Report, p. 241; Productivity Commission, *National Access Regime*, October 2013, p. 84-86; Productivity Commission, *Review of the Gas Access Regime*, June 2004, pp. 87-88, and p. 174.

⁶ Productivity Commission, *Productivity Commission Inquiry Report: National Access Regime, No 66, 25 October 2013*, <https://www.pc.gov.au/inquiries/completed/access-regime>, pp 7-8.

and an ability and incentive to deny access or restrict output and charge monopoly prices.⁷ In the PC's view, the NAR should be retained as there are likely to be circumstances where the benefits of access regulation are likely to outweigh the costs where there is a monopoly provider of infrastructure services. Overall, the PC determined that the NAR is likely to generate net benefits to the Community.⁸

13. The Panel conducting the Competition Policy Review (Harper review) also agreed with the PC's conclusions that the NAR is likely to generate net benefits to the community and should continue to provide a backstop to the current industry-specific access regimes.⁹
14. Despite recognising the possibility that regulation may be needed in some instances to address the essential facilities problem, the NAR has never proceeded on the assumption that regulation of all infrastructure services was appropriate. Instead, it recognised that regulation came at significant costs (both in terms of the act of regulation; and in terms of the potential for regulatory risk and disincentives for efficient investment). This led to the introduction of certain criteria that must be met before a service was subject to regulation. Similar risks and costs of regulation have been noted by the PC.¹⁰
15. Further, the Hilmer Committee's proposed reforms placed primacy on commercial negotiations between gas pipeline owners and potential access seekers when determining terms and conditions of access for those services that met the criteria for regulation. It was envisaged that regulation (by arbitration) would occur only when commercial negotiations between pipeline owners and potential access seekers did not lead to agreed outcomes. This approach of regulation only following failed negotiation is referred to as a "negotiate-arbitrate" model of regulation.
16. In its review of the NAR, the PC determined that the negotiate-arbitrate framework remains an important feature of the NAR. The PC considers that if there were no threat of arbitration, it is clear that service providers can have incentives to delay negotiations and frustrate access seekers.¹¹ The PC regards the negotiate-arbitrate framework as providing a sound basis for resolving access disputes under Part IIIA.¹²
17. The focus on promoting commercial negotiation as a means to determine terms and conditions of access recognises that direct regulation imposes regulatory costs/burdens, and could in some circumstances distort dynamic efficiency and discourage infrastructure investment given the risks associated with investment and the possibility of low access prices being set.
18. Natural gas pipelines typically have natural monopoly characteristics (e.g. large, sunk investment and economies of scale), which could serve to provide owners of these

⁷ Ibid, pp 7-8

⁸ Ibid, p 10.

⁹ Harper et al, *Competition Policy Review: Final Report*, March 2015, <https://treasury.gov.au/publication/p2015-cpr-final-report>, p 431.

¹⁰ Productivity Commission, *Productivity Commission Inquiry Report: National Access Regime, No 66, 25 October 2013*, <https://www.pc.gov.au/inquiries/completed/access-regime>, p 104.

¹¹ Ibid, p 120.

¹² Ibid, p 128.

pipelines with market power. This gives rise to the potential for gas pipelines to suffer from the essential facilities problem – thereby enlivening considerations of whether access to these pipelines should be regulated.

19. While the NCC has reservations regarding the need and/or benefits of a blanket approach to regulation which assumes all gas pipelines should be subject to at least some form of access regulation, the NCC accepts it is the view of the Commonwealth, state and territory governments that access regulation should be extended to almost all gas pipelines.¹³
20. On the assumption that any future regime will involve some baseline level of access regulation for practically all natural gas pipelines, the NCC considers two over-arching principles should govern whatever package of reforms the COAG Energy Council ultimately recommends:
 - First, the regime should continue to have at its focus a guiding objective such as that presently contained in the National Gas Objective (NGO). This appropriately directs attention to the long-term interests of consumers by promoting efficient investment in, and efficient use and operation of, natural gas services. The NGO recognises the importance of balancing the productive, allocative and dynamic efficiencies in the provision of pipeline services as well as in upstream and downstream markets—where competition is a key driver of welfare gains. The significance of this is that the regime should seek to preserve the notion that access to all gas pipeline services should not be the subject of full regulation; and that in many circumstances, it will be sufficient only to have a form of light regulation of gas pipeline services incorporating a form of a negotiate-arbitrate model
 - Second, policies aimed at promoting commercially negotiated outcomes wherever possible should be encouraged, against a backdrop that provides meaningful opportunities for parties to seek arbitration when negotiations fail to delivery mutually acceptable outcomes. This means that the focus of any light-handed regulation that might act as a baseline for regulation of all non-scheme gas pipeline services should be on the disclosure of information that would have the effect of improving the ability of commercial negotiations to resolve terms and conditions of access to these services.
21. Consistent with these objectives, the NCC sets out below elements it considers should be contained within any reform package recommended by the COAG Energy Council.

Tensions between light-handed regulation and Part 23 of the NGR

22. As noted in the Consultation RIS, there are presently three forms of regulation possible for access to natural gas pipelines:
 - Full regulation for certain gas pipelines “covered” under the NGL
 - Light regulation for those other gas pipeline services covered under the NGL

¹³ The exception is pipelines that do not provide third party access.

- Following amendments made in 2017, a baseline form of regulation under Part 23 of the NGR for all non-scheme pipelines involving a form of negotiate-arbitrate model.
23. The NCC has previously observed that many aspects of the Part 23 regime bear similarities to light regulation for covered pipelines.¹⁴ Further, during the AEMC’s review into the scope of economic regulation to be applied to natural gas pipelines, some stakeholders raised concerns that full and light regulation of pipelines appear to be subject to less stringent information disclosure obligations and less detailed arbitration mechanisms compared to those that apply to pipelines subject to Part 23. It was suggested that these regulatory inconsistencies were undesirable, and could lead to ‘forum shopping’.¹⁵
24. To alleviate these concerns, the NCC considers it appropriate to remove the co-existence of Part 23 of the NGR and light regulation under the NGL; and instead adopt a single form of light regulation that would apply to all non-scheme pipelines similar to that contained under Part 23 of the NGR. In addition, however, the NCC considers provision should still remain for full regulation of those gas pipeline services that meet certain coverage criteria, similar to the regime for full regulation set out under the NGL. In effect, this would involve a more streamlined regulatory regime with two forms of regulation:
- A form of light regulation for all non-scheme pipelines (which would not require satisfaction of any coverage criteria)
 - A form of full regulation similar to that presently contained under the NGL that would require satisfaction of certain coverage criteria.
25. The NCC is mindful that this type of model would require arrangements for transitioning those gas pipelines subject to light regulation under the NGL to some form of regulation similar to that under Part 23 of the NGR. However, the NCC does not consider these to be insurmountable challenges.¹⁶

Information disclosure requirements

26. Consistent with the objective of promoting commercially-negotiated outcomes where possible, the NCC considers the main focus of a mandatory light-handed regulatory regime should be on ensuring the disclosure of relevant information that would assist commercial negotiations between gas pipeline owners and access seekers.
27. In this respect, the NCC supports an information disclosure requirement for all non-scheme pipelines similar to that set out in Part 23 of the NGR; and which requires gas pipeline owners to disclose information on basic price and non-price terms for each service; service and access information; and financial information. The disclosure of essential information on pipeline facts would enable potential shippers to consider whether to enter into commercial negotiations with owners and to form a reasonable

¹⁴ NCC, *AEMC draft report: Review into the scope of economic regulation applied to covered pipelines*, available at http://ncc.gov.au/images/uploads/NCC_submission_-_Final_Version_%28Submitted%29.pdf, p 7.

¹⁵ Ibid, p 8.

¹⁶ Ibid, p 9.

view of what the outcome of these negotiations might be, whilst not being too onerous on pipeline owners. The NCC considers that information disclosure of this type improves transparency, reduces transaction costs, and reduces the imbalance in bargaining power that typically exists between pipeline owners and access seekers.

28. The NCC considers that exemptions might be available for greenfields and very small, dedicated pipelines. However, it considers that it may not be necessary to have these exemptions if the regulatory (i.e. information disclosure) requirements are light enough.

Negotiate/arbitrate

29. The NCC supports the emphasis of the Part 23 regime on using an arbitration mechanism to facilitate private commercial negotiation between pipeline service providers and shippers; and considers this should be retained. The NCC also considers there should be the opportunity to seek commercial arbitration if certain timeframes are exceeded for commercial negotiations.

Coverage test

30. As indicated above, the NCC considers that the regime should provide for the ability of access seekers or any interested parties to seek coverage/full regulation (for price and non-price terms) if they are unsatisfied with the outcomes of light handed regulation. The NCC considers that the option of full regulation should remain given the size and the economic importance of gas pipelines and the potential for serious constraints on competition and adverse economic outcomes if particular gas pipelines owners have enduring market power. Given all non-scheme natural gas pipelines will be subject to a form of light-handed regulation under the NCC's preferred reforms, the NCC considers full coverage would only be sought in rare circumstances.
31. The process and the coverage criteria should be amended to be the same as that currently applying to other monopoly infrastructure like ports and airports under Part IIIA of the CCA. Consistent with its 24 December 2019 submission, the NCC considers an independent agency such as the NCC (or NCC equivalent) should consider applications for gas pipeline coverage and provide recommendations to the Minister, with tight timeframes so as to provide certainty to parties and minimize the risk of delays to regulatory decision-making processes.
32. The NCC wishes to reiterate that it is important to ensure that that an independent agency provides advice as to whether a facility should be regulated. The NCC considers that the regulator of particular services should not be put in a position of determining what services should be subject to full regulation of price and non-price terms and conditions, for the reasons set out in our 24 December 2019 submission.
33. Further, and consistent with its 24 December 2019 submission, the NCC considers a Minister should make decisions regarding what gas pipeline services should be regulated where decision-making criteria involve considerations of the effect of regulation on the public interest.

Conclusion

34. Overall, the NCC considers there are elements within each of the four proposed reform packages that could contribute toward a coherent reform proposal. However, the NCC does not favour any of the four proposed packages set out in the COAG Consultation RIS in their entirety. Whilst not proposing a comprehensive reform package of its own, the NCC does consider any package recommended by the COAG Energy Council should:

- Be guided by over-arching objectives that are consistent with the existing NGA; and which seek to give primacy to commercial negotiations for resolving terms and conditions of access rather than full regulation wherever possible
- Involve streamlining of existing regulatory options by removing the option for light regulation of covered pipelines that presently exists under the NGL. Instead, all non-scheme pipelines should be subject to some form of light regulation similar to that contained in Part 23 of the NGA, with a focus on mandatory information disclosure that assists with commercial negotiation of the terms and conditions of access to natural gas pipelines.
- Further, provision should still remain for full regulation in exceptional circumstances where it can be shown that particular gas pipeline services meet coverage criteria consistent with those set out in recent amendments to Part IIIA of the CCA. The NCC considers this would only be sought in exceptional circumstances.
- Decisions over what gas pipeline services should be covered should not be made by those bodies charged with regulating these services. Instead, the existing independent agency recommendation/Ministerial decision-making process should be retained; with time limits imposed to reduce delays in decision-making processes (consistent with our recommendations on governance arrangements set out in our 24 December 2019 submission).