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7 October 2003

Mr Tony Hinton
Presiding Commissioner
Gas Access Regime Inquiry
Productivity Commission
LB2 Collins Street East
MELBOURNE VIC 8003

Dear Tony

Issues raised in Sydney hearing on 18 September 2003

During the Australian Competition and Consumer Commission's (ACCC) appearance at the Productivity Commission hearing on the National Gas Access Regime in Sydney on 18 September 2003 you directed a number of questions to the ACCC which were taken on notice. This supplementary submission addresses the issues you raised at the hearing.

I would be pleased to provide further submissions if there are any additional issues that you would like to raise with the ACCC.

Yours sincerely

A handwritten signature in black ink that reads "Mike Buckley". The signature is written in a cursive style with a large, sweeping flourish at the end.

Mike Buckley
General Manager – Gas

Attachment A

Australian Competition and Consumer Commission

Supplementary submission to the Productivity Commission Review of the Gas Access Regime:

Issues directed to the ACCC in Sydney Hearing on 18 September 2003

7 October 2003

Ring fencing

At the hearing, Mr Hinton indicated that to date the Productivity Commission had received only one complaint on how the ring fencing provisions of the Code have been operating and that the Productivity Commission would be interested in hearing the ACCC's views on how the ring fencing provisions were operating and whether they were appropriate. Dr Folie also sought the ACCC's views on the related topic of accounting guidelines.

Ring fencing is designed to assist the introduction of effective competition into markets traditionally supplied by natural monopolies. Ring fencing involves putting structures in place to prevent flows of information and personnel, and inappropriate transferring of costs and revenues within a vertically integrated utility and between related regulated and unregulated businesses.

Without adequate ring fencing, it is likely that a vertically integrated firm or group of related businesses will be faced with incentives for anti-competitive behaviour. Such behaviour may include providing preferential treatment to upstream and downstream operations or related entities, transfer pricing and the sharing of information between operations or related businesses. Ring fencing limits the scope for these types of anti-competitive behaviour with the aim of allowing all upstream and downstream entities to compete on a level playing field.

The Code provides minimum ring fencing obligations. The ACCC has responsibility under section 4 of the Code to monitor compliance with these obligations and commence enforcement action if the provisions are breached.

The Code places obligations on service providers of regulated gas transmission pipelines to report to the regulator at reasonable intervals as required. The ACCC requires reports from service providers on an annual basis.

Broadly, the minimum obligations in the Code as set out in section 4.1 require the service provider to:

- be a legal entity;
- not carry on a Related Business (essentially a business of producing, purchasing or selling Natural Gas);
- establish and maintain separate accounts for the activity that is the subject of each Access Arrangement;
- establish and maintain a consolidated set of accounts for all the activities undertaken by the service provider;
- allocate costs shared between different accounts in a fair and reasonable manner;

- ensure that confidential information is not disclosed to any other person without the permission of the person to whom the information pertains;
- ensure that marketing staff do not work for both the service provider and an associate taking part in a related business.

The Code provides scope for the regulators to impose additional obligations on service providers in section 4.3. At this stage the ACCC has not done this. The Code also includes provisions regarding waiving some of the minimum ring fencing obligations.

In 2001, the ACCC sought ring fencing compliance reports from service providers for the first time. While the 2001 reports varied in the level of detail provided, the ACCC decided that the information provided by service providers for that year was adequate given that they were the first such reports.

The variation in the 2001 reports indicated that some service providers were unsure of the level of information required. Accordingly, to assist service providers with the compliance reporting process and standardise the information provided to the ACCC, a pro-forma report was developed for service providers to use as the basis for the 2002 and subsequent compliance reports. This was designed to ensure that the information provided fulfils the reporting requirements of the Code without creating an unreasonable regulatory burden on service providers.

The reporting requirements included sign-off from both the CEO and an external director. These requirements ensure that service providers' boards of directors have considered the compliance procedures and are aware of the measures that have been put in place to meet the ring fencing obligations. The approval and sign-off requirements in place mean that the board of directors of each company are accountable for the information provided in the report. They also provide the ACCC with sufficient confidence that a thorough assessment of obligations has been undertaken by each service provider.

Service providers were advised that the ACCC proposed to make the reports publicly available on the ACCC website.

All relevant service providers submitted reports that substantially complied with the reporting requirements specified by the ACCC. The reports described the procedures and processes in place and provided an assessment of their adequacy as required by the Code.

Future Reporting

For the 2003 report, the ACCC continued to require that service providers submit ring fencing reports based on the pro-forma report. The ACCC considers that the reporting requirements set out in the pro-forma and in particular the approval requirements will ensure that each service provider's ring fencing reporting obligations are met.

Due to the ambiguity around whether the ring fencing provisions of the Code applied to Queensland service providers, the ACCC decided that these service providers would not be required to submit reports until their access arrangements were finalised. The access arrangements for the Ballera to Mt Isa Pipeline, the Roma to Brisbane Pipeline, the Wallumbilla to Gladstone/Rockhampton pipeline and the Ballera to Wallumbilla Pipeline

have now been finalised. Service providers for these pipelines have submitted compliance reports for the year ending 30 June 2003.

Several of the compliance reports submitted in 2000 raised the issue of multiple service providers for pipelines. The Gas Pipelines Access Law defines a service provider as the pipeline owner or operator of a covered pipeline. Where there is more than one service provider for a pipeline, section 10 of the Code requires that each service provider comply with the ring fencing provisions in section 4. The Commission followed up on this issue at the commencement of the 2002-03 reporting period and now receives reports from all identified service providers.

Accounting separation

Section 4.1 of the Code requires that a person who is a service provider in respect of a pipeline must:

- Establish and maintain a separate set of accounts in respect of the services provided by each covered pipeline in respect of which the person is a service Provider;
- Establish and maintain a separate consolidated set of accounts in respect of the entire business of the service provider; and
- Allocate any costs that are shared between an activity that is covered and any other activity, according to a methodology for allocating costs that is consistent with section 8.1 of the Code and is otherwise fair and reasonable.

Section 4.2 of the Code provides that the regulator may publish general accounting guidelines that specify how the service provider is to prepare its accounts. Service providers are required to comply with any such guideline. Section 4.2 also states that such guidelines may, amongst other things, require service providers' accounts to contain sufficient information, and to be presented in such a manner, as would enable the verification by the regulator of the calculation of reference tariffs for covered pipelines.

In accordance with the ring fencing provisions of section 4.2 of the Code, the ACCC will shortly be releasing for comment its Draft Accounting Guidelines. It may be the case that such a guideline could assist the industry in standardising its accounting practices so that it is better able to demonstrate compliance with the accounting separation requirements of the Code.

NGPAC

Mr Hinton sought the ACCC's views on the role and operation of NGPAC. In particular, Mr Hinton inquired whether NGPAC was capable of dealing with substantive issues.

In responding to this issue the ACCC is mindful that there are current processes going on within governments and within CoAG that are considering governance issues in the energy sector. Moreover, the issue of governance is appropriately a matter for government.

The structure and functioning of NGPAC is substantially influenced by the legislative provisions that have been put in place for establishing the Code. The legislative basis of the Code necessitates the participation of all jurisdictions in the Code change process. Decision making in such an environment must take into account the views of each jurisdiction.

The ACCC observes that the Code has been amended on seven occasions as set out below:

- 23 Dec 1999: Clarified that methodologies in s8 may be applied on either a nominal or real basis and dealt with some issues on inflation. Changed some definitions.
- 9 Nov 2000: Inserted 2.15A, new 2.16, inserted 2.16A, new s2.19 and 2.20, inserted 2.37A, new 2.38, inserted 2.38A, new 2.41 and 2.42. New 4.1, 4.15, 7.19, 10.8. These had some significant changes to process and information disclosure.
- 22 Nov 2001: New 8.4. Incentive mechanisms were modified to allow the service provider to retain some of the savings made.
- 27 Jun 2002: Amended 8.36, clarified that non-capital costs may include generic market development activities.
- 6 Feb 2003: Amendments to ss 1, 2, 3, 5, 7, 8, 10. Most important was the inclusion of ss 8.3A-H detailing tariff variation methods within an access arrangement period.
- 17 Apr 2003: Changes to ss8 and 10 covering investment in new facilities and what may/may not be included in the cost of new facilities.
- 24 Apr 2003: Inserted s2.4A, amended 2.28, inserted 2.28A and 2.28B. Allows a single access arrangement to cover two or more pipelines.

NGPAC is an advisory body with responsibility for making recommendations to governments on amendments to the Code. Accordingly the current structure which limits voting rights to the jurisdictions is appropriate. The decision making process within NGPAC, however, is assisted by the presence of representatives from regulators, industry and users in a non-voting capacity. These representatives bring extensive industry experience and familiarity with the operation of the Code and can provide valuable guidance to the jurisdictions.

To date NGPAC has not been tested with a substantial proposed amendment to the Code.