PRODUCTIVITY COMMISSION REVIEW OF THE GAS ACCESS REGIME

SUBMISSION TO THE ISSUES PAPER

by the

DEPARTMENT OF INFRASTRUCTURE, VICTORIA

With the approval of the Victorian Government

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SECTION 1: INTRODUCTION AND SUMMARY

The Department of Infrastructure (DOI) welcomes the opportunity to make a submission to the Commission's review of the Gas Access Regime.[1] The Commission has been directed to consider a broad range of issues in the review. This submission focuses on the issues that are most relevant for Victoria, and the Victorian Government's objectives for the energy sector. As will be clear from the submission, the effective functioning of the Regime is of substantial importance to Victoria. As such, it is imperative that the Commission's assessment of the Regime be based upon careful analysis and on actual evidence of its operation, and that any changes the Commission recommends for the Regime be practicable.

Energy and the natural gas industry in particular are essential to the continued growth of the Victorian economy and employment, as well as to the well-being of Victorian households. Victoria has a relatively mature gas market with a high level of domestic and business use compared to other states, and there are substantial opportunities for gas-fired generation to supply peak electricity demand in the future.

In 2002, the Government released its detailed policy for the energy sector in Victoria, *Energy for Victoria*.[2] As part of this policy the Government identified its key objectives for energy policy as providing secure and sustainable energy services at efficient and affordable prices. Clearly, as the regulatory framework for the monopoly gas infrastructure all over Australia – including Victoria – the effective functioning of the Gas Access Regime ('the Regime')[3] is critical to meeting the Government's objectives.

In the context of the Commission's current review of the Gas Access Regime, the requirements for the Regime that DOI considers are particularly important are as follows.

- *Providing a robust regulatory regime for the monopoly elements of the industry* – which is essential for the promotion of competition in the upstream and downstream sectors, and for ensuring that customers are protected from the potential for the misuse of market power (while also continuing to attract the investment required to provide reliable energy supplies over the long term);

- *Facilitate the construction of 'greenfields' transmission pipelines* – gas supplies from either or both the remote north or north west of Australia may be required to meet Victoria's energy needs over the medium to long term. It is imperative that the Regime not impede projects to connect these resources to the south east

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1 The Gas Access Regime comprises the Gas Access Pipelines Law, the National Third party Access Code for Natural Gas Pipeline Systems and the Inter-Government Natural Gas Pipelines Access Agreement (7 November 1997).

2 Department of Natural Resources and Environment, *Energy for Victoria: A Statement by the Minister for Energy and Resources*, 2002, available at www. www.doi.vic.gov.au/doi/internet/energy.nsf.

3 In this submission the term 'the Regime' is used to refer collectively to the Gas Access Pipelines Las, the National Third Party Access Code for Natural Gas Pipeline Systems and the Inter-Government Natural Gas Pipelines Access Agreement.

Australian gas network when the connection of such supplies would be efficient; and

- *Facilitate the extension of natural gas into Victorian country towns* – the Government's objective is to ensure a reliable and affordable supply of energy to all Victorians, including residents in regional and rural Victoria. It is important that the Regime not impede the extension of gas supply to areas not currently served where such projects are commercially viable. It is also important that the Regime facilitate governments to support the extension of natural gas networks to towns that may not be commercially viable, but where a government considers that wider benefits may flow from such a project, and justify government assistance.

This submission sets out DOI's views on the extent to which modifications to the Regime as currently drafted and / or applied are either required or desirable, given the factors set out above. The main conclusions reached are as follows.

- *Effective regulatory regime* – the form of regulation applied under the Regime and its application to the mature Victorian gas distribution and transmission systems has been very effective in meeting the Government's objectives of promoting competition in the supply and retailing of gas, ensuring that the customers served by these networks have access to gas at affordable prices, and in promoting growth in energy dependent industries. The 'negotiate/arbitrate' model for these networks is not supported.

  However, DOI would support revisions to the Code if required to permit refinements to the application of incentive regulation (for example, the use of TFP trends to set the X factor in price cap plans), should this prove superior to existing approaches. DOI would also support simplification of the Code's pricing principles, provided that the more important constraints on regulators' powers are retained (such as the methodology for updating regulatory asset values). DOI supports the insertion of an unambiguous primary objective in the Regime, and considers that the objective in the *Essential Services Commission Act 2001 (Vic)* provides an appropriate model.

- *No barriers to greenfields gas transmission projects* – DOI supports the adoption of the Parer Review[4] recommendations for greenfields projects, namely clarifying or ensuring that an upfront (pre-construction) regulatory approval of an access arrangement is permitted; permitting an access holiday if specified conditions are met, provided that certainty is provided as to how the regulatory value for the asset will be set should it be covered at the end of the holiday; and permitting the National Competition Council to issue a binding ruling on whether a pipeline would pass the coverage test in the future, prior to the pipeline being constructed.

- *Greenfield gas distribution projects* – the Victorian Government has recognised that there are broader social benefits of access to natural gas that are not included

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[4] W. Parer 2002, 'Towards A Truly National and Efficient Energy Market', Council of Australian Governments, Energy Market Review.

in companies' commercial assessments, such as reduced energy costs, greenhouse emissions and social benefits of more affordable energy. In recognition of these wider benefits associated with the extension of reticulated natural gas into country Victoria, the Government has committed $70 million to assist such projects. The expectation has been that most of these projects would be covered by an existing distributor's access arrangement. This submission sets out several recommendations for change to the Code to better facilitate these projects in general, including where governments wish to provide support.

However, DOI considers that the full range of possible measures for greenfields projects should also be extended to distribution projects, amongst other things, to provide governments with more flexibility over how to leverage private investment into gas extension projects in country towns. While the Victorian Government is unlikely to use the Code's *formal* competitive tendering process in its current natural gas extension program, DOI considers that, in certain circumstances, a process like that envisaged currently in the Code may be a desirable method of delivering such projects and simultaneously setting reference tariffs. However, it considers that substantial simplification to the current competitive tendering provisions is warranted.

In addition, DOI has also proposed that the current legal structure of the Regime – in particular, the inter-relationships between the Gas Access Pipelines Law ('the Law') and the National Third Party Access Code for Natural Gas Pipeline Systems ('the Code') – be simplified to better reflect the relative importance of various provisions in the Regime. Such a rationalisation would be essential were the role of assessing changes to the Code to be transferred to the proposed Australian Energy Market Commission (AEMC). Lastly, the submission responds to two technical issues with the Victorian implementation of the Regime that have been raised in submissions, namely, the appeals that are available from the decisions of the Essential Services Commission (ESC), and the objectives the ESC is required to consider when administering the Regime.

SECTION 2: VICTORIA'S GAS INDUSTRY AND ENERGY POLICY OBJECTIVES

Characteristics of Victoria's Gas Industry

Victorian gas consumption

Victoria consumes 28 per cent of Australia's annual natural gas production for domestic markets. The state has one of the largest natural gas markets within Australia. Victoria has the highest rate of access to natural gas (per 1,000 population) in Australia. Reticulated natural gas is available in most Victorian cities and large towns. In 2000, 90 per cent of Victorian households had access to gas mains and 85.4 per cent of households were connected to gas.[5]

Households with access to natural gas will often use gas for space heating, water heating and/or cooking, and electricity for lighting and other appliances. Domestic use of natural gas — particularly for winter heating — is the highest in Australia. The energy source mix used by businesses varies according to the nature of the business and the price and quality of energy supply.

Gas is used as both a primary and secondary source of energy. It is estimated that between 2000-2010 primary gas consumption in Victoria will increase by 3.28 per cent per year.[6] This is due to the growing availability and competitiveness of natural gas.

Secondary gas consumption, which grew slowly over 1990-2000, is projected to grow more rapidly over 2000-2010 with an expected annual growth rate of 2.08 per cent.[7] One of the main uses is for gas-fired electricity generation. Construction of three gas-fired generators was completed in Victoria in 2002: Duke Energy at Bairnsdale, Valley Power in the Latrobe Valley and AGL at Somerton. The proportion of electricity generated from natural gas is projected to rise due to:

- its lower greenhouse emissions;
- its greater suitability for meeting Victoria's infrequent peak demands for electricity;
- the scope to install gas-fired generation in small increments; and
- the savings in transmission costs that can come from locating gas-fired plant close to loads.

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5 Australian Gas Association, Gas Statistics Australia, 2001, p. 103.

6 NIEIR 2002, as cited in Department of Natural Resources and Environment, *Energy for Victoria: A Statement by the Minister for Energy and Resources*, 2002, p. 46, available at www. www.doi.vic.gov.au/doi/internet/energy.nsf.

7 NIEIR 2002, as cited in Department of Natural Resources and Environment, *Energy for Victoria: A Statement by the Minister for Energy and Resources*, 2002, p. 48, available at www. www.doi.vic.gov.au/doi/internet/energy.nsf.

Victorian gas supply

Victoria is heavily reliant on off-shore natural gas production. In 1969 natural gas from offshore Gippsland via the Longford gas plant rapidly displaced the existing supply of towns gas. Minor gas production from the Otway basin west of Melbourne started in 1987. The interconnect to the Eastern Australian Pipelines Ltd (EAPL) and hence to gas from the Cooper Basin was completed in 1998.

Currently there are five sources of natural gas in Victoria, with most natural gas being supplied from the off-shore Gippsland and Otway basins in Bass Strait. The principal Bass Strait gas fields are operated by the Bass Strait Joint Venture (Exxon-Mobil/BHPBilliton). The five existing sources of gas are:

- Esso's Gippsland processing plant at Longford, which processes the Bass Strait gas and currently supplies approximately 95 per cent of natural gas in Victoria;

- The interconnection between Victoria and NSW near Albury, primarily enabling Cooper Basin gas to flow southwards into Victoria;

- Small onshore Otway Basin gas fields whose gas is processed by the Underground Gas Storage Facility at Iona, linked to the state's main gas transmission network via a pipeline from Port Campbell to Lara, near Geelong and to the Western Transmission System supplying the Western District;

- The Underground Gas Storage Facility at Iona with a holding capacity of up to 12 PJ (depleted gas field storage) for winter ; and

- LNG from the GasNet Dandenong Plant.

Gas production from the Gippsland and Otway Basins currently meets Victorian demand. It is expected that within the next few years additional sources will be supplying gas to Victoria from off-shore fields. Additional gas sources, each with its own processing plant, are currently being developed and gas will be sourced from:

- the Otway Basin (Minerva 2004, Geographe, Thylacine, Casino all 2006) where reported supplies to date total 1700 PJ;

- a new development in the Gippsland Basin (Patricia-Balleen) now supplying into the 12 PJ/y EGP which is linked to Victorian system at Longford by VicHub;

- the Bass Basin project sourcing gas from the Yolla field in the Bass Basin that will supply 20PJ/y of gas at Pakenham by winter 2004.

These developments will complement the main Gippsland Basin fields and the Longford plant. With the new sources by 2005 Victoria will be a significant exporter of gas to New South Wales, South Australia and Tasmania. Victoria can also import small quantities of gas from New South Wales if required to meet peak demand, and future opportunities exist to diversify sources of supply through cross-border pipeline developments.

However, maintaining the long term security of supply of natural gas is an important issue for the state of Victoria. At projected levels of consumption in Victoria and accounting for future exports to S.A. and NSW, gas reserves in the Otway, Bass and Gippsland Basins will be depleted between 2015 and 2030 unless significant new discoveries are made. Thus, in the long-term the DOI anticipates that it may be necessary to bring new supplies of gas into Victoria from sources including the Timor Gap, Papua New Guinea or the greater Northwest Shelf region.

Gas market structure

Prior to the reforms of the 1990s, Victoria's gas industry effectively comprised two players. The Government-owned Gas and Fuel Corporation was responsible for natural gas transmission, distribution and retail activities, and the Esso-BHP Gippsland Basin joint venture supplied the vast majority of natural gas.

During the 1990s, substantial changes to the structure of the natural gas market were made. The former Gas and Fuel Corporation was separated into a transmission entity and three stapled gas distributor/retailers, and privatised. In addition, a wholesale spot-market for gas was created, under the administration of the Victorian Energy Networks Corporation (VENCorp). The purpose of the spot market was to create a market-based mechanism for balancing gas and rationing capacity on the principal gas transmission system, increasing the transparency of price signals to which market participants may respond, and facilitating the entry of new producers and retailers into the Victorian gas market. Reflecting this change, institutional arrangements were put in place to subject the private businesses to independent economic regulation by the now Essential Services Commission and safety regulation by the Office of Gas Safety.

The three distribution networks are now owned by Envestra, TXU Networks, and Multinet, and the three initial retailers are owned by Origin Energy, TXU Retail and AGL, and the transmission entity is owned by GasNet Ltd. In addition, a number of new retailers have entered the market. Duke Energy owns and operates the Eastern Gas Pipeline between Longford and Sydney, and the proposed SEAGas pipeline planned to link the Otway Basin fields with South Australian markets will be owned by a consortium comprising Origin Energy, TXU and National Power. A number of new gas producers either supply or will supply gas into the Victorian market in the near future, including Origin Energy, Santos and BHP Billiton.

Retail competition in gas has been effective for large users and is becoming increasingly effective for small users. Over seven per cent of domestic gas customers have chosen a different retailer since full retail competition was introduced in October 2002. The number of customers now changing retailers each month is increasing significantly, suggesting that competition for small users is taking effect.

The Government has a comprehensive consumer protection framework to provide small consumers with access to gas at reasonable prices and standards of service while full retail competition is becoming effective. The Essential Services Commission (ESC) will review the effectiveness of competition in late 2003 and early 2004. The Government will decide on any ongoing need for and form of consumer protection arrangements in light of the ESC's report.

Energy policy objectives and priorities for the Gas Access Regime

From the discussion above, it is clear that energy and the natural gas industry in particular is essential to the continued growth of the Victorian economy and employment, as well as to the well-being of Victorian households. Victoria has a relatively mature gas market with a high level of domestic and business use compared to other states, and there are substantial opportunities for gas-fired generation to supply peak electricity demand in the future.

In 2002, the Government released its detailed policy for the energy sector in Victoria, *Energy for Victoria*.[8] As part of this policy the Government identified its key objectives for energy policy being to provide secure and sustainable energy services at efficient and affordable prices. More specifically, its energy policy objectives are to:[9]

- Ensure an efficient and secure energy system.

  — This requires ongoing investment in both supplies and the efficient use of those supplies. We need to provide for the state's economic and social well being as cost-effectively as possible.

- Ensure those supplies are delivered reliably and safely.

  — The reliable distribution of energy – particularly electricity, which cannot be stored on a significant scale – is an ongoing challenge. Fossil fuels and electricity are inherently hazardous, so they must be distributed and used safely.

- Ensure consumers can access energy at affordable prices.

  — The Government is committed to ensuring all consumers, especially low income earners, can access essential energy services at affordable prices.

- Ensure our energy supplies and the way we use them are environmentally sustainable – and in particular less greenhouse intensive.

  — Achieving sustainability is a key challenge for Victoria. We generate most of our low cost electricity from brown coal, which brings major economic benefits but also contributes about half of our greenhouse gas emissions. We have to find ways to ensure our mix of energy sources and our use of them minimises damage to the environment and economy and in particular reduce the intensity of our greenhouse emissions.

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[8] Department of Natural Resources and Environment, *Energy for Victoria: A Statement by the Minister for Energy and Resources*, 2002, available at www. www.doi.vic.gov.au/doi/internet/energy.nsf.

[9] Department of Natural Resources and Environment, *Energy for Victoria: A Statement by the Minister for Energy and Resources*, 2002, p. 5, available at www. www.doi.vic.gov.au/doi/internet/energy.nsf.

As a result of industry reform undertaken in the early 1990s discussed above, the provision of secure and efficiently priced energy depends largely on the successful operation of energy markets, continued private sector investment in essential infrastructure and the effective regulation of the monopoly elements in the relevant industry.

Clearly, as the regulatory framework for the monopoly gas infrastructure all over Australia – including Victoria – the effective functioning of the Regime is critical to meeting the objectives set out above. In the context of the Commission's current review, the requirements for the Regime that DOI considers particularly important are as follows.

- *Providing a robust regulatory regime for the monopoly elements of the industry* – which is essential for the promotion of competition in the upstream and downstream sectors, and for ensuring that customers are protected from the potential for the misuse of market power (while also continuing to attract the investment required to provide reliable energy supplies over the long term);

- *Facilitate the construction of 'greenfields' transmission pipelines* – gas supplies from either or both the remote north or north west of Australia are likely to be required to meet Victoria's energy needs over the medium to long term. It is imperative that the Regime not impede projects to connect these resources to the south east Australian gas network when the connection of such supplies would be efficient; and

- *Facilitate the extension of natural gas into Victorian country towns* – the Government's objective is to ensure a reliable and affordable supply of energy to all Victorians, including residents in regional and rural Victoria. It is important that the Regime not impede the extension of gas supply to areas not currently served where such projects are commercially viable. It is also important that the Regime facilitate governments to support the extension of natural gas networks to towns that may not be commercially viable, but where a government considers that wider benefits may flow from such a project, and justify government assistance.

DOI's views on whether the Regime meets these requirements, and where it considers that modifications are required, are provided in sections 3 to 6 below.

SECTION 3: REGULATION OF MATURE GAS NETWORKS

Overall Objectives for the Gas Access Regime

DOI is aware that there has been a degree of debate about the precision of guidance for regulators under the Regime, particularly in light of the Epic decision.

DOI would support amendments to the Regime to clarify the guidance provided to regulators, noting that this is likely to reduce regulatory uncertainty, and also reduce the scope for disputation and hence the costs incurred by the various parties in administering or complying with the regime. As currently drafted, the Regime would appear to contain a large number of objectives, factors and principles to which regulators either may or must have regard when exercising discretion, but no overriding principle that would permit the guidance from these different objectives, factors, or principles to be reconciled.

The legislation for the Victorian ESC is a model that the Commission may wish to consider. The relevant section is reproduced below.[10]

> 8. ***Objectives of the Commission***
>
> (1) In performing its functions and exercising its powers, the primary objective of the Commission is to protect the long term interests of Victorian consumers with regard to the price, quality and reliability of essential services.
>
> (2) In seeking to achieve its primary objective, the Commission must have regard to the following facilitating objectives-
>
> (a) to facilitate efficiency in regulated industries and the incentive for efficient long-term investment;
>
> (b) to facilitate the financial viability of regulated industries;
>
> (c) to ensure that the misuse of monopoly or non-transitory market power is prevented;
>
> (d) to facilitate effective competition and promote competitive market conduct;
>
> (e) to ensure that regulatory decision making has regard to the relevant health, safety, environmental and social legislation applying to the regulated industry;
>
> (f) to ensure that users and consumers (including low-income or vulnerable customers) benefit from the gains from competition and efficiency;
>
> (g) to promote consistency in regulation between States and on a national basis.
>
> (3) Without derogating from sub-sections (1) and (2), the Commission must also perform its functions and exercise its powers in such a manner as the Commission considers best achieves any objectives specified in the relevant legislation under which a regulated industry operates.

This model in which the regulator has two-tiers of guidance – a primary objective and facilitating objectives – permits the potentially competing advice from the facilitating objectives to be weighted and reconciled against an overarching criterion. A two-tiered structure would also be easily accommodated into the Regime, for example, maintaining some or all of the criteria set out in sections 2.24, 6.15 and 8.1 as facilitating objectives, although some rationalisation of these numerous criteria would be desirable.

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[10] Essential Services Commission Act, 2001 (Vic).

Regarding the precise primary objective, DOI considers that the primary objective set out in the ESC Act – to 'protect the long term interests of Victorian consumers with regard to the price, quality and reliability of essential services' – suitably modified would be appropriate. This objective is consistent with the overriding objective for a number of the UK economic regulators, as well the objective for the telecommunications regulatory regime. The requirement to focus on the *long term* interests of customers would not guide regulators to favour short term price reductions at the expense of a reduction in ongoing investment, but rather to consider the full implications of regulatory decisions – including the impact on investment and consequently on long term reliability and security of supply. Such an objective would also not be inconsistent with 'efficiency in the use of, and investment in, infrastructure' as favoured by the Commission in its Part IIIA Report, as these objectives, for the most part, should coincide.

Form of Regulation under the Gas Access Regime

DOI considers that the form of regulation under the Regime and its application to the mature Victorian gas distribution and transmission systems has been very effective in meeting the Government's objectives of promoting competition in the supply and retailing of gas, ensuring that the customers served by these networks have access to gas at affordable prices, and in promoting growth in energy dependent industries.

In particular, DOI considers that setting prices with reference to cost is appropriate for the entities that are in a position to exercise substantial market power, given an objective of maximising growth in related industries and protecting customers, while also ensuring that sufficient incentive exists for the investment required in the industry to continue to provide a highly reliable gas supply over the long term. DOI also considers that the approval of prices up-front by a regulator, and the consequent ability for retailers to enter into 'off of the shelf' access agreements, is important for minimising the barriers to entry for new retailers, and for ultimately establishing effective and sustainable competition in retailing.

It should be noted that Victoria took steps to reduce the extent of regulatory risk borne by the new owners of the privatised gas transmission and distribution assets. The detail of the access arrangements for the three Victorian gas distributors and the transmission entity and the detailed rules for the VENCorp spot market were developed, submitted to the relevant independent regulators and approved by those regulators prior to the entities being privatised. Indeed, establishing robust regulatory arrangements for the monopoly elements of the industry was a precondition to their privatisation, reflecting the importance of natural gas to Victorian customers and industry.

DOI understands that a number of gas industry participants have proposed that the current form of regulation under the Code – whereby reference tariffs are approved upfront by a regulator – be replaced by a system whereby access charges are settled through negotiation between retailers and the infrastructure owner, with the potential for recourse to binding arbitration. Following from the discussion above, DOI is not convinced that a 'negotiate and arbitrate' system of regulation would be appropriate for the monopoly elements of the gas industry, at least in the mature markets like Victoria. First, it is not clear that such a regulatory model will be effective in protecting customers from the misuse of monopoly power. Secondly, reverting to a

'negotiate and arbitrate' model would most likely impose additional costs on new retailers, which may deter entry, and thus slow down then creation of effective and sustainable competition in the retailing of gas. Of particular concern is that smaller new entrants may be at a significant disadvantage to the larger incumbent retailers, which could hinder or deter retailers seeking niche markets and offering innovative services.

Another important element of the Victorian gas industry is the wholesale gas spot-market under the supervision of VENCorp. DOI considers that the creation of this spot-market under independent supervision has been essential to the increase in the diversity of gas production and to the level of rivalry in retailing that has been observed in Victoria (and is essential to the eventual creation of sustainable, effective competition for the smaller customers). The design of the wholesale gas market has been endorsed by the National Competition Council and the Australian Competition and Consumer Commission (ACCC), who concluded that the wholesale market provides a sound basis for competition, is consistent with the competition principles and do not pose a barrier to interstate trade in gas.

As part of its recent approval, the ACCC required VENCorp to undertake a review of the current gas spot market pricing and balancing arrangements to examine the potential benefits associated with a pricing approach capable of reflecting within-day constraints on the Principal Gas Transmission System. VENCorp is currently undertaking that review, and will make recommendations on options to improve the efficiency and effectiveness of the gas spot market arrangements, having regard to emerging developments in the south east Australian energy sector, and the Government's overall energy policy objectives. The final report of the review is expected in March 2004.[11]

While the Regime could do more to support or encourage market-based arrangements for ensuring efficient system balancing, capacity management and price transparency, an important feature of the Regime is that the flexibility exists for such arrangements. It is essential that this flexibility under the Regime be preserved.

Potential for Improvement in the Form of Regulation

A number of comments have been made about the costs incurred by both regulators and regulated entities in the administration of the Regime. It is noted that the regulatory processes conducted to date have involved the detailed consideration of a number of technical and often contentious issues, and have required significant time and resources to be devoted by both the regulators and the regulated entities. Comments have also been made that there is a lack of incentive for companies to improve (or maintain) their performance under the form of regulation under the Regime, as applied by regulators.

DOI does not consider that either the level of detail of the regulators' examinations of matters presented to them, or the resources consumed in these regulatory processes, have been out of proportion to the significance of the issues to both the owners of the

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[11] Detail about the *Gas Market Pricing and Balancing Review* is available on the VENCorp website at http://www.vencorp.com.au/html/index.htm?consultations

privatised businesses and to Victorian gas consumers and industry. In addition, it is noted that transparency in decision making, consistent with good public policy as well as the Commission's own views,[12] has added to the length and perceived complexity of regulatory decision making, but is essential to a well-functioning regime.

That said, DOI considers it appropriate for regulators to seek to minimise the administrative costs of regulation where possible, particularly where this can also improve effectiveness of the regulatory regime for achieving its objectives. Clearly, it is important for the Regime to encourage any possible improvements in regulatory practice.

The regulatory arrangements put in place for the Victorian energy sector sought to encourage the use of incentive regulation as a means of reducing the cost and improving the effectiveness of price regulation. The decisions of the Victorian ESC have also emphasised the use of commercial incentives for encouraging regulated entities to act in a manner that is consistent with the public interest. A recent report on best practice incentive regulation for the Utility Regulators Forum has described further potential refinements for the application of incentive regulation in Australia. It concluded, amongst other things, that consideration should be given to using measures of historical productivity growth to set the X factor in the price cap that applies between price reviews (after resetting prices initially in line with cost), rather than setting X implicitly using forecasts of expenditure and demand (ie the 'building block' approach).[13] That report also noted that changes to the Regime may be required to permit regulators to adopt such an approach for the gas industry.

DOI would support removing any barriers that may exist within the Regime to regulators applying best-practice incentive regulation, and the model discussed above is one that it would desirable to permit regulators to develop further. DOI notes, however, that it is important to retain balanced expectations about the potential benefits from any change to the current 'building block' approach. The Commission should also bear in mind that whether or not there is support for particular changes to the current price setting approach may well become blurred by parties' expectations of the relative outcomes of the different approaches.

Simplification of the Gas Access Regime – Pricing Principles

DOI is also aware of the concerns that have been expressed that the current pricing principles that are set out in section 8 of the Code may contain an unnecessary level of detail, which may create confusion, and could create the risk that a regulator is constrained to make a decision that is less than optimal (although we are unaware of any such examples that have not been remedied through a change to the Code). DOI would support a simplification of the pricing principles in the Code, in particular, to focus them more on the outcomes sought from the pricing principles, rather than forming a detailed set of implementation rules.

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[12] Productivity Commission, 2001, Review of the National Access Regime, Inquiry Report, p.356 and ch.15.

[13] Farrier Swier Consulting, Comparison of Building Blocks and Index-Based Approaches, Report to the Utility Regulators Forum, June 2002.

That said, DOI would caution against removing all of the constraints on regulatory decision-making that are imposed by the section 8 pricing principles. Some of the principles – most notably, the methodology prescribed for updating the value of the regulated assets from one review to the next – are highly desirable, providing more certainty to investors, and also reducing the potential for dispute when reference tariffs are reviewed.[14] Thus, the simplification of the pricing principles should ensure that the desirable constraints on regulatory decision making are retained in a simplified version of the principles.

DOI also considers that a simplification of other elements of the Regime – as well as a review of the legal structure of the Regime (that is, the allocation of the matters dealt with in the Law and Code) – is also warranted, which is discussed in section 6 below.

[14] The advice received prior to the privatisation of the regulated electricity businesses was that the regulatory value assigned to the assets in the future was a key concern to investors. Accordingly, the regulatory values for the electricity distributors were locked-in prior to their privatisation: Victorian Electricity Supply Industry Tariff Order, June 1995, clause 5.10.

SECTION 4: REGULATORY ARRANGEMENTS FOR GREENFIELD TRANSMISSION PIPELINES

As noted above, at projected levels of consumption, gas reserves in the Otway and Gippsland Basins will be depleted between 2015 and 2030 unless significant new discoveries are made. Thus, gas supplies from either or both the remote north or north west of Australia may be required to meet Victoria's energy needs over the medium to long term. It is imperative that the Regime not impede projects to connect these resources to the south east Australian gas network when the connection of such supplies would be efficient.

DOI notes that substantial new investment in regulated infrastructure has been installed or committed to under the Regime as currently drafted, including the construction of the Eastern Gas Pipeline, the pipeline to Tasmania, and SEAGas pipeline. Indeed, notwithstanding that the general criticisms of the Regime as having an adverse impact on investment, little in the way of direct evidence of an impact on investment has been presented, and little in the way of substantive changes to the Code have been proposed by the relevant industry participants, who have the ability to propose changes to the Code through the current National Gas Pipeline Access Committee (NGPAC) Code change process. That said, DOI considers that the facilitation of future greenfields investment is sufficiently important to warrant the Commission in its current inquiry considering any refinements to the Regime that may be appropriate to accommodate the specific features of substantial greenfields gas projects.

The recent Parer Review considered the issues of greenfield investments,[15] and made a number of recommendations it considered would increase the certainty with respect to the impact of the Regime on those projects (see Box 1).

BOX 1
PARER REVIEW RECOMMENDATIONS ON GREENFIELD TRANSMISSION PROJECTS

Recommendation 7.1

The Gas Code should be amended to enable proponents of new pipelines to seek a binding ruling from the National Energy Regulator on coverage under the Code prior to construction. In making an application for a binding ruling, companies can propose the period of the binding ruling — with the obligation upon the applicant to provide arguments in support of the period sought. Any binding ruling granted would not be subject to potential revocation due to material changes in circumstances for the period granted unless the regulator relied on information that is proved to be false or intentionally misleading. A decision to grant a binding ruling of no coverage for a defined period should be subject to merits and judicial appeal.

Recommendation 7.2

If a proposed transmission pipeline is likely to be covered, the proponent can commit to a 15 year economic regulation free period. To qualify, the pipeline company must commit to providing access, publishing tariffs, making all capacity it contracts tradeable and have sufficient vertical separation of ownership (i.e. no upstream or downstream firm has sufficient ownership to exert control over the pipeline in a way that might lessen competition in upstream or downstream markets). At the end of the 15 year period, an assessment will be made as to whether the pipeline company is exercising market power. If it is, the pipeline will be deemed to be covered. If it is not, the pipeline will not be covered.

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[15] Parer W 2002, Towards A Truly National and Efficient Energy Market, Council of Australian Governments, Energy Market Review.

Recommendation 7.3

Alternatively, the proponent of a prospective pipeline can enter into an up-front agreement with the National Energy Regulator prior to construction, locking in a number of key regulatory parameters for extended periods of time. This can provide regulatory certainty for the period agreed with the NER.

Subject to the comments below, DOI considers that these recommendations have merit, and so should be given due consideration by the Commission.

Regarding the last of these options, it is noted that industry participants in the NGPAC raised a number of concerns about the capacity of regulators to approve an access arrangement prior to a pipeline being constructed.[16] In DOI's view, the suggested barriers that may prevent regulators from being able to approve such an access arrangement prior to construction and for an appropriate length of time are in the nature of technical constraints (often arising only from the definitions of key terms), and that remedying such potential barriers should be uncontroversial.[17]

DOI also notes that, for its part, the ACCC as the prospective regulator of greenfield transmission pipelines has been pro-active in its efforts to clarify the degree of flexibility in the Regime for dealing with the special features of greenfields projects.[18] DOI considers that for projects that are likely to be in a position of substantial market power in the future, having an access arrangement approved upfront, reference tariffs approved for an extended period (say, 15 to 20 years), certainty as to how the regulatory asset base will be calculated after that period and possibly other pricing principles locked in for a substantial period of time, is likely to offer an important option for project proponents. The ACCC's *Guideline* should assist project proponents wishing to avail themselves of this route by providing a framework within which proponents can frame their detailed proposals to the ACCC.

DOI also supports the Parer Review recommendation that prospective greenfield transmission projects be able to obtain an initial period during which they would not be required to have reference tariffs approved pursuant to the principles in section 8 of the Code, subject to the conditions the Parer Review specified. These conditions are that the pipeline company must commit to providing non-discriminatory access, publish their third-party tariffs, permit contracted capacity to be traded, and not have any significant interest in upstream or downstream activities. The principle behind this option is that the difficulties associated with a regulator assessing reference tariffs for an initial period of a greenfield pipeline's operation (in particular, the potential variation in profitability) are such that a price regulation-free period should be preferred.

That said, DOI notes that the 'access holiday' option requires certainty on the rules for transition of pipelines to the regulatory regime, should they become covered after

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16 These matters are discussed in the submission from the NGPAC secretariat to the current inquiry.

17 The simplification to the pricing principles in section 8 of the Code that has been suggested in section 3 of this submission may be expected to remove many potential technical or definitional barriers.

18 ACCC, Draft Greenfield Guideline for Natural Gas Transmission Pipelines, 2002.

the expiration of the holiday. If the current approach to pricing under the Code is maintained (that is, prices continue to be set with reference to cost), then the main element for which certainty is required is how the regulatory value of projects would be calculated at the end of the holiday-period, should they become covered.

- If unconstrained, a regulator could set a regulatory value for the project at the end of the holiday-period that removed any ex post monopoly profits – contrary to the intent of the holiday.

- Similarly, if unguided, a regulator may be led to accept a regulatory value that generated windfall rents in addition to those intended by the holiday, and unnecessarily suppress investment and employment in related industries.

Given the extreme degree of controversy that has been associated with the initial regulatory asset base for pipelines when they have first been regulated under the Regime, DOI considers that the holiday option requires a mandated, well-specified methodology for deriving the regulatory value for these projects at the end of the holiday. Of course, to the extent that alternatives to cost-based pricing may be devised, either through the Commission's current review or in the future, then rules for transition relevant to that alternative price-setting regime would be required.

Lastly, an additional consideration for the Commission should be to ensure that, if a series of options are introduced for greenfields projects, those options should operate in a seamless and coherent fashion. While DOI supports service providers with choice where their selection is likely to be consistent with the public interest, it is important that perverse incentives or unnecessary gaming opportunities be avoided.

SECTION 5: REGULATORY ARRANGEMENTS FOR GREENFIELD DISTRIBUTION PROJECTS

As noted above, it is important that the Regime not impede the extension of gas supply to areas not currently served where such projects are commercially viable. It is also important that the Regime facilitate governments to support the extension of natural gas networks to towns that may not be commercially viable, but where a government considers that wider benefits may flow from such a project, and justify government assistance.

Under the current regulatory framework in Victoria, users within one kilometre of a gas distribution network have a right to connection through their local distributor on fair and reasonable terms. No distributor is obligated to reticulate new areas beyond the one kilometre limit. In practice, this obligation to connect – and the ability for a regulator to resolve disputes about the terms of the offer of connection – ensures only that customers in an area already reticulated with natural gas, or immediately adjacent thereto, are able to obtain access to natural gas.

In Victoria in the past, there have been a number of instances where towns more than one kilometre from the existing distribution network have expressed interest in having the gas distribution network extended but those extensions have not proceeded. It has been claimed by a number of parties that the regulatory regime may have provided an impediment to such projects proceeding. It is clear, however, that a reason for a number of projects not proceeding has been that they have not been assessed as commercially viable from a business perspective. In its last review of the access arrangements for the three Victorian gas distributors, the ESC addressed the issue of potential regulatory barriers to these projects at some length, and accepted the distributors' proposals to alleviate these potential regulatory barriers.[19]

The Victorian Government has recognised that there are broader social benefits of access to natural gas that are not included in companies' commercial assessments, such as reduced energy costs, greenhouse emissions and social benefits of more affordable energy. In recognition of these wider benefits associated with the extension of reticulated natural gas into country Victoria, the Government has committed $70 million to assist such projects.[20]

The expectation is that most of all of the new extensions that would be part-funded under this program would be 'extensions and expansions' to an existing Victorian distributors' system, that is, included under its existing access arrangement. This treatment permits a distributor to 'pool' cost and demand risk across the discreet projects that it undertakes and thereby reduce the risk it bears, thus extending to the customers of new extension projects the standard regulatory approach that applies to customers already served with natural gas.

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[19] Essential Services Commission, 2002, Final Decision: Review of Access Arrangements, pp.50-56.

[20] Further information about the Natural Gas Extension Program is available from: http://www.business.vic.gov.au.

DOI notes that, while the Regime as presently drafted has not prevented the Government from offering this type of support, changes to the Regime would be desirable to reduce further the potential for the regulatory regime to become a barrier to projects proceeding.

One potential barrier that has been identified is uncertainty on the part of investors with how a regulator may apply the tests for deciding whether to permit capital expenditure to be included in the regulatory asset base. These tests include that the expenditure be prudent and (in effect) that the new customers not be subsidised by existing customers (sections 8.16(a) and (b)(i) of the Code) and are required to be applied at the next access arrangement review, that is, after a project is likely to have commenced. While the Victorian Essential Services Commission has applied these tests in a pragmatic manner to date, it is clear that the tests provide the regulator with a degree of latitude. This degree of latitude exists at two levels: which are, first, the methodology the regulator may use when applying these tests, and secondly, the results from applying that methodology to a particular case (which includes the view the regulator may take on such matters as a proponent's expenditure and revenue forecasts).

The Code currently permits a regulator to undertake an upfront assessment of a project against these tests (section 8.21), which would provide substantial certainty on the regulatory treatment of a particular project. The problem with the Code's existing pre-approval process, however, is that the regulator is required to undertake the same consultation process it would apply as if it were assessing a whole access arrangement. Even with a regulator keen on fast-tracking the process, such a process would take a number of months to complete.[21] Accordingly, a highly desirable change to the Code would be to provide the regulator with more discretion as to the level of consultation it undertakes when considering whether to provide upfront approval to a new project under section 8.21.[22]

Not all project proponents may require a regulator to provide an upfront approval of a particular project before commencing, but may be satisfied with further (formal) guidance on the methodology the regulator may use to apply these tests. Accordingly, a second change to the Regime that DOI considers would be desirable would be for the Regime to recognise guidelines that a regulator may issue on how it may administer these provisions, and to encourage regulators to issue such guidelines. In addition, simplification to the Regime's pricing principles as advocated in section 3 above would provide further assurance that the Regime would not inadvertently prevent a government from assisting such projects, should it choose to do so. An explicit mention of the possibility of government support in the Code – should a government wish to provide support – would provide further legal clarity.

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[21] This requirement comes about indirectly. Section 8.21 refers to a proposed revision submitted under section 2.28, and the relevant section for determining whether the full consultation is required is section 2.33. A regulator would be expected to consider that an approval under section 8.21 would 'result in changes to Reference Tariffs' and so fail the test for permitting a reduced level of consultation.

[22] In section 6, DOI notes more generally that it would be desirable for some of the highly detailed procedural requirements in the Code to be simplified. A more fit-for-purpose consultation requirement for section 8.21 approvals may be a by-product of such a simplification.

DOI considers it desirable, however, that the full range of possible measures for greenfields projects also be extended to distribution projects. The Parer Review's rejection of greenfield options for all distribution projects was arbitrary, as projects to extend reticulated gas to large towns with natural gas may be substantial infrastructure projects, and share many of the characteristics of greenfields transmission projects (that is, uncertain cost of construction, uncertain take-up rates etc). Providing the full range of measures for greenfield distribution projects would provide governments with more flexibility over the means through which it provided assistance to such projects, should it choose to do so.

While it is not the approach that is likely to be used under the Victorian Government's Natural Gas Extension Program, DOI also considers that a formal competitive tendering process of the type currently set out in the Code, in the appropriate case, may provide an effective means of encouraging new distribution projects, and simultaneously setting regulated charges or the level of subsidy required.

While it is envisaged that the Government may use competition between project proponents to ensure that the effectiveness of program funding is maximised, as noted above, it is envisaged that new extension projects will incorporated into the distributors' existing access arrangements. The formal competitive tendering provisions in the Code assume that a new project would be financially 'ring fenced' from any other activities, and then subsequently operated on a stand-alone basis. Thus, the ability to 'pool' risk with other projects would be ruled out.

However, a substantial simplification to the tendering principles in the Code is warranted, in particular, to remove the excessive emphasis on process, which unnecessarily raises the cost of undertaking such a process. A broadening of the permitted criteria for selecting the 'winning tender' is also required for this device to be useful for governments to use to sponsor particular projects.

By way of example, rather than selecting the tenderer that offers the *lowest price*, it may be appropriate to select the tenderer that requires the lowest subsidy for a given price, or a mixture of the two – for example, the lowest price up to a maximum, and then the lowest subsidy if a higher price otherwise would have been required. In addition, where a government contemplates giving assistance to a project, it would be appropriate to permit other criteria to influence the relative ranking of different bidders to ensure that the best overall package for customers is selected – such as the speed with which the system will be rolled-out, and the area to be served.

SECTION 6: OPTIONS FOR IMPROVING THE LEGAL STRUCTURE OF THE REGIME

DOI considers that the Commission's current inquiry into the Regime provides an opportunity to revisit the legislative structure of the Regime, and in particular, for the allocation of provisions between the legislation and the extrinsic Code to better reflect the relative importance of those provisions in the Regime, as well as to simplify the overall framework.

Moreover, as the Commission would be aware, Australian Energy Ministers have been considering the appropriate form of the institutional arrangements for rule making under the gas and electricity codes. One option being considered is the establishment of the AEMC to fulfil the rule-making and market development functions for both the electricity and gas industries. An implication of this option is that the roles of both NGPAC and the Code Registrar would be subsumed by the AEMC, and Ministers would no longer have a direct role in approving changes to the Code. It follows that if this option is adopted, it will be especially important to ensure that key provisions establishing important principles are entrenched in the legislation, and not subject to the ordinary rule change process.

The present legislative structure of the Regime derives from the *Natural Gas Pipelines Access Agreement* of 7 November 1997. Pursuant to that agreement it was decided that all the States and Territories would enact uniform laws to provide for third party access to natural gas pipeline systems. There were two different means agreed for enactment of those laws as follows:

- In the case of all States and Territories apart from Western Australia; South Australia would enact lead legislation which the other States and Territories would then apply in their own jurisdictions by 'application of laws' legislation;

- Western Australia would separately enact its own legislation that would be substantially the same as the South Australian legislation. In other words, Western Australia did not directly apply the South Australian legislation but instead replicated it.

The 1997 *Natural Gas Pipelines Access Agreement* contained a number of Annexes. Annex A was the draft *Bill for the Gas Pipelines Access (South Australia) Act 1997*. Annex B described itself as the 'Gas Pipelines Access Law' but was in fact the draft for Schedule 1 to the South Australian Act. Annex D contained the draft *National Third Party Access Code for Natural Gas Pipeline Systems* which was Schedule 2 to that act. The effect of this structure was three tiers to the regulatory regime (in addition to the intergovernmental agreement) in all jurisdictions except Western Australia:

- the main body of the Act;

- the Law in Schedule 1 (which is enacted by one jurisdiction and merely 'applied' by the remainder); and

- the Code in Schedule 2 (which may be amended without reference to Parliaments).

Box 2 sets out the distribution of various provisions between these instruments.[23]

BOX 2
LOCATION OF KEY PROVISIONS IN THE REGIME: CURRENT

The main body of the Act

The main body of the Act contains three principal kinds of provisions:

- Provisions applying the Gas Pipelines Access Law and the Code in the jurisdiction concerned;
- Provisions establishing a national administration and enforcement regime; and
- Provisions establishing a local administration and enforcement regime.

The Law in Schedule 1

The law in Schedule 1 contains nine principal kinds of provisions:

- Provisions providing for the Code and its amendment (Part 2);
- Provisions providing for applications and determinations of pipelines as transmission or distribution pipelines ie classifications of pipelines (sections 9 –12);
- A provision prohibiting the preventing or hindering of access to a pipeline (section 13);
- Provisions providing for arbitrations of access disputes and the procedure to be followed in those arbitrations (Part 4). Note that most of the provisions in this Part are procedural;
- Provisions stating the remedies available for breach of the Law and Code (Part 5);
- Provisions allowing administrative review (Part 6);
- A provision as to price for supply and haulage of natural gas (section 40);
- Provisions as to provision of information (sections 41 – 43); and
- Provisions as to interpretation of the Law and Code (Appendix to Schedule 1).

The Code in Schedule 2

The Code contains eleven principal kinds of provisions:

- Provisions for coverage (section 1 and Schedule A);
- Provisions requiring the submission of access arrangements and then providing for the procedure for their approval (section 2);
- A provision setting out the matters that a Regulator "must take into account" when approving an access arrangement (section 2.24);
- Provisions stating what must be contained in an access arrangement (sections 3.1 – 3.20);
- Provisions allowing the determination of tariffs in respect of Greenfield pipelines by competitive tenders and providing for how those tenders are to be approved (sections 3.21 – 3.36);
- Provisions for ring-fencing (section 4);
- Provisions as to provision of information and timelines for negotiation (section 5);
- Provisions as to arbitration (section 6);
- Provisions setting out the reference tariff principles (section 8);
- Provisions governing Code change (section 9);
- Miscellaneous interpretation and definitional provisions (section 10).

A number of comments can be made about this structure:

[23] Necessarily this is a summary only and as such may come at some expense of accuracy.

- There is a degree of inconsistency. For instance, the classification provisions appear in Schedule 1 but the coverage provisions appear in the Code. Both involve Ministerial decisions and it can well be argued that both should appear in the Law. Similarly procedural provisions governing arbitrations appear in Schedule 1 when they might equally have been inserted in section 6 of the Code;

- There are various overlaps. Thus arbitration provisions appear both in Schedule 1 and the Code as do Code amendment provisions, interpretation provisions and provision of information provisions. Similarly the enforcement provisions appear both in the main body of the Act and in Schedule 1.

- Provisions that are of considerable significance to the Regime are in the Code, sometimes 'buried' in obscure places. By way of example, section 2.24 of the Code which is (per *Re Dr Ken Michael AM; Ex parte Epic Energy (WA) Nominees Pty Ltd & Anor (2002) ATPR 41-886)* of much importance to regulatory determinations appears as an ordinary provision buried in the middle of section 2 of the Code.

Moreover, this distribution of the provisions is unlikely to be consistent with principles of good regulatory drafting. There are three principal reasons for this:[24]

- First, to the extent that key provisions are in the Schedules, particularly when they appear in the Code in Schedule 2, it suggests that the provisions are not as important as provisions appearing in the Law. This sends the wrong signals – especially with provisions such as section 2.24 of the Code. For similar reasons, it would also be inappropriate for an overarching objective for the Regime (as discussed in section 3 above) to be inserted into the Code rather than in the Law;

- Secondly, to the extent that there are inconsistencies and overlaps of the sort noted, this does not aid regulatory efficiency and accountability in that considerable time and money has to be expended in resolving those matters, in some instances through the courts; and

- Thirdly, to the extent that key provisions are in the Code, and those provisions may be amended (as they can be) by simple agreement between the relevant Ministers, this makes the Code a less certain instrument than the Law in Schedule 1 or the main body of the Act itself. This too sends the wrong signals in terms of (investment) certainty, accountability etc.

Assuming that the rule making function is transferred over to the AEMC at some stage, and that the current structure of a main Act, an applied Act and a Code that can be changed without reference to Parliaments, a legislative structure along the lines set out in Box 3 might be considered appropriate.[25] Note that this is a first view only, and

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[24] Other reasons such as lack of clarity, confusion, difficulty in interpretation, compliance difficulties can readily be thought of. These reasons are, arguably, just as important as those that appear in the main text.

[25] These suggestions necessarily involve considerable summarisation again at the expense of some accuracy.

that a more detailed assessment of the appropriate location of the respective provisions would be appropriate.

BOX 3

LOCATION OF KEY PROVISIONS IN THE REGIME: POSSIBLE OPTION

Main body of the Act:

To continue to provide for the application in each jurisdiction of the Law and the Code as well as for national and local enforcement and administration.

The Law in Schedule 1:

To contain all substantive provisions but not to include any procedural or administrative provisions. Thus it could include:

- A generic provision recognising the Code and allowing for it to be amended by the AEMC (if it is vested with that task);
- Provisions providing for classification and coverage of pipelines;
- A provision requiring the submission of access arrangements and stating what must be contained in an access arrangement;
- Provisions setting out the matters that a Regulator "must take into account" when approving an access arrangement. I would not suggest that this include the Reference Tariff Principles currently included in section 8 of the Code as those principles strike me as more matters of detail and as such better suited to being in the Code;
- Provisions allowing for the determination of tariffs "by other means" (eg competitive tenders) in the case of Greenfields pipelines;
- Provisions for ring-fencing;
- A provision prohibiting the preventing or hindering of access to a pipeline;
- Provisions providing for arbitrations of access disputes (but not the procedure to be followed in those arbitrations);
- Provisions stating the remedies available for breach of the Law and Code;
- Provisions allowing administrative review;
- A provision as to price for supply and haulage of natural gas;
- Provisions as to provision of information.

The Code in Schedule 2:

To include all procedural, administrative and detailed (methodology) provisions. Thus it could include:

- Provisions setting out the procedure for amendment of the Code;
- Provisions providing for the procedure for the approval of access arrangements;
- Provisions stating what procedure is to be followed in the case of determination of tariffs for Greenfields projects;
- Provisions setting out Reference Tariff Principles as per section 8 of the Code;
- Provisions as to timelines for negotiation;
- Provisions as to procedure for arbitration;

New Schedule 3:

To contain the interpretation and definitional provisions that are common for the legislation (including the Code) as a whole.

As will be appreciated, the effect of this legislative restructure will be to move all provisions that provide for matters of principle into the Law with the exception of those few that remain in the main body of the Act. The Code would then be restricted to matters of detail and procedural and administrative matters.

Moreover, as discussed in section 3 of this submission, DOI considers that simplification of the detailed pricing principles currently contained in section 8 of the Code would be appropriate, subject to not removing provisions that are important for providing certainty (in particular, the rules for updating the regulatory values of assets at price reviews). Simplification to other detailed provisions in the Code may also be appropriate – such as to the detailed procedural requirements for assessing access arrangements and access arrangement revisions. Again, important principles currently contained in these provisions should be retained, such as requirements for regulators to undertake effective consultation prior to making decisions, and also to require high levels of transparency in the process, including the disclosure of key information to enable users and consumer representatives to participate in a price review.

Other Matters

In submissions to the Commission's review, two criticisms have been made about the implementation of the Regime in Victoria, namely that:

- the provisions for administrative appeal from decisions of the ESC are those in the Essential Services Commission Act 2001 (Vic), rather than the provisions in the Regime;[26] and

- the objectives set out in the Essential Services Commission Act 2001 (Vic) override the various objectives set out in the Regime.[27]

It is DOI's view that neither of these statements is correct. To clarify the matter, the reasons and relevant provisions are described below.

Regarding the appeal rights from the ESC's decisions, there are three steps in the analysis.

- First, section 21(4) of the Gas Pipelines Access (Victoria) Act 1998 provides that section 55 of the Essential Services Commission Act 2001 does not apply in relation to the Gas Pipelines Access (Victoria) Act 1998. Section 55 establishes the right of appeal to the Appeal Panel from ESC decisions. The net effect of that provision is to require that appeals from the ESC to the Appeals Panel (where such appeals lie) only go ahead in accordance with the provisions of the Law.

- Secondly, section 22(1) of the Gas Pipelines Access (Victoria) Act 1998 then provides that 'civil proceedings' may not be brought in respect of any matter arising under the GPAL or the Code except in accordance with Part 5 or 6 of the Law. In Part 6, it is section 39 which allows merits reviews by the Appeals Panel where the ESC drafts and approves its own access arrangement or access arrangement revisions. Again, however, as the Appeal Panel is involved,

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[26] Australian Gas Association, Submission to the Productivity Commission Inquiry into the Gas Access Regime, 2003, p.48; TXU, Submission to the Productivity Commission Inquiry into the Gas Access Regime, 2003, p.13.

[27] Envestra, Submission to the Productivity Commission Inquiry into the Gas Access Regime, 2003, p.17.

section 21(4) of the Gas Pipelines Access (Victoria) Act 1998 will apply, meaning that section 55 of the Essential Services Commission Act 2001 does not apply.

- Thirdly, further 'appeals' from the Appeals Panel can only be brought by judicial review in the courts (see section 32(4)(c) of the Law). The grounds for judicial review under the Law are similar to (but not exactly the same as) those stated in section 62 of the Essential Services Commission Act 2001 (note that section 62 prohibits civil proceedings in respect of decisions of the ESC and the Appeals Panel except where either body acted 'without power' or failed to comply with procedural requirements, although the 2001 judgment of Gillard J in TXU Electricity v ORG [2001] VSC implied that an error of law may suffice to make the ESC act 'without power'). However, in any event, section 62 is not relevant because it must be read subject to the 'special provision' in section 32(4) of the Law (see Application of Epic Energy South Australia Pty Ltd (2003) ATPR 41-932 @ 46,923).

It follows that the appeals mechanism in the Essential Services Commission Act 2001 should not override that established by the Gas Pipelines Access (Victoria) Act 1998.

Regarding the objectives relevant to the ESC's decision-making under the Regime, it is not the case that the objectives of the ESC under the Essential Services Commission Act 2001 (including the objective of protecting the long term interests of Victorian consumers), override any objectives specified in the Gas Pipeline Access Law, for the following reasons.

- First, section 8(3) of the ESC Act also requires the ESC to perform its functions and exercise its powers 'in such a manner as the [ESC] considers best achieves any objectives specified in the relevant legislation under which a regulated industry operates.' The Law is relevant legislation, and accordingly the ESC Act specifically requires the ESC to consider those objectives in performing relevant functions.

- Further, section 5(2) of the ESC Act provides that 'if the [ESC] considers that there is a conflict between the objectives specified in or under [the ESC Act] and the objectives specified in the relevant legislation under which a regulated industry operates, the [ESC] must perform its functions and exercise its powers in such a manner as [the ESC] considers best achieves the objectives specified in the relevant legislation'. Accordingly, to the extent there is an inconsistency between the objectives under the ESC Act (including the primary objective of protecting the long term interests of consumers) and the objectives specified in the Law, the ESC is required to give precedence to the objectives specified in the Law.

It follows that the objectives in the ESC Act cannot override the objectives set out in the Regime. However, it is the case that there is no provision in the relevant legislation that provides that the ESC is not to consider its objectives under the ESC Act (including the primary objective of protecting the interests of consumers) in making an access arrangement determination. Moreover, the ESC is only required to give precedence to objectives under the Law if there is conflict between the objectives of the ESC under the ESC Act and the objectives specified in the Law.