Submission to the Productivity Commission's Gas Access Regime Inquiry
Personal Perspective of the Chairman, National Gas Pipeline Committee (NGPAC)

April, 2003

Preface

This submission is based on my personal observations and opinions formed during:
(a) the consultation and negotiation process leading to the CoAG National Gas Pipeline Agreement, Law and Code ("the regime"), during which I participated as Chairman of the Australian Gas Association; and
(b) My role as Chairman of the National Gas Pipeline Advisory Committee (NGPAC) since its establishment under the regime.
Any views expressed in this submission on the adequacy of the Code or the role of NGPAC in the context of its remit as contained in the CoAG National Gas Pipelines Access Agreement ("the Agreement") – see recital B, 2.1, 9.1 and 9.4 of the Agreement – are my own and should not be taken to reflect the views of NGPAC. Neither is it my purpose to defend the performance of NGPAC nor promote its continued existence past its "use by" date, what ever that may be. I am interested in improving the performance of NGPAC, while it continues, and in optimising the administration of the Code and Code Change process into the future.

A further reason for making this submission is to ensure that the experiences and "corporate memory" of NGPAC, of what was intended and what actually happened, of what works and what does not, will be available to the Inquiry. While I am not wedded to a particular solution or way forward, neither should any of us be satisfied with a continuation of the current role and performance of NGPAC in "the administration of the Code" as defined Clause 9 of the Agreement.

1. Background

1.1 In the early 1990s the principles contained in Hilmer Report gained remarkably bi-partisan support within and among the various Federal, State and Territory governments of Australia ("the jurisdictions").

1.2 These Hilmer principles applied to "utilities" would produce a paradigm shift in regulation, away from "price justification" and price setting, towards facilitation of the development of a true market for gas and gas services, specifically through adoption of nationally consistent and equitable terms of third party access to transmission and distribution services in gas and electricity.

1.3 The natural monopoly position of existing utilities would be neutralised by ring fencing and other degrees of separation, limiting the service providers to derive a transparent, fair and reasonable return from transmission and distribution assets and services, thus eliminating anticompetitive cross subsidisation of marketing of the energy form (and potentially vice versa). With access to the ultimate consumer of the energy form by potential new energy suppliers and marketers thus guaranteed, development of a true market for gas and electricity was confidently anticipated.

1.4 Light-handed regulation was seen a feasible as market forces would guarantee a fair outcome in most instances. The concept of national regulatory uniformity also had wide appeal, despite a recognition that no two States or Territories had even similar gas markets and infrastructure.

1.5 This market oriented approach seemed particularly appropriate for gas in the mid-1990s, as Australia's oldest and, at the time, second largest gas utility (AGL) had always been a public company, rather than a state owned instrumentality. Other pipelines and distribution assets were also privately owned. Australia's then largest gas utility (Gas & Fuel Corporation of Victoria) was about to be transferred from state to private ownership.

1.6 The element of existing and imminent private ownership in gas was important to the way the Code was developed. Unlike electricity, where governments owned pretty well all of the assets, the evolution of the Gas Code had to take account of the rights of service providers to challenge or frustrate the process by seeking to enforce constitutional rights in relation to alienation of property rights (eg to the income earning capacity of their assets. Service provider/asset owners could also individually to pursue asset specific third party access terms by way of "undertakings" available under Part IIIA of the Trade Practices Act (which could have put beyond reach the prize of uniformity).

1.7 While service providers did not push their luck, certain principles are embedded in the Code which reflect their unique position and hence pre-requisites. Thus it was always going to be the case for gas that the service provider would "propose" the terms of access and the regulator would "dispose". That is, the initiative for defining the services offered was to remain with the owner/operators of the assets rather than being for the regulator or potential user to dictate. Also, no fundamental property right of the asset owners was to be abrogated to the regulators' discretion without a right of appeal on the basis of merit/equity (as opposed to mere failure or defect in the administrative process). And, importantly, the body set up to administer the Code should continue to include the key stakeholder groups in addition to jurisdictions.

1.8 The main concerns of third party transmission and distribution service users and potential users revolved around availability of and access to relevant commercial and technical data, particularly tariff sensitive data, not only by Regulators but also by users and potential users.

1.9 While a "vanilla flavoured" service would be offered by service providers to all comers in the respective Access Arrangements requirements in the Code, it was also anticipated that many larger gas suppliers and large consumers would negotiate "bespoke" arrangements, using the datum points in the published Access Arrangement as a framework around which to negotiate terms to suit their respective and different priority service and supply requirements.

1.10 It should also be recalled that Australia, at that time, had virtually no "home grown" expertise in market driven utility access regimes and hence was open to many, not always apposite, foreign expert opinions and suggestions. The characteristics of the Australian utility industry had neither the diversity of supply, nor transmission infrastructure, nor consumer market depth and hence neither the ability nor present need sufficient to incorporate many of the experts' proposed regulatory provisions. But because these market characteristics were certainly important goals, quite a bit of effort was taken up debating some of the sophisticated regulatory proposals.

1.11 Never-the-less, it is a credit to those involved, that a uniform national regime for gas was developed as a framework, rather than a fully comprehensive (and hence hypothetical) regulatory monolith. There was, at the time, a practical recognition that private ownership of infrastructure and competitive markets would grow in unforeseen and indeed unforeseeable ways. The essence of the regime was therefore to lie in its flexibility to respond to practical situations in the marketplace as they arose rather than in an attempt to anticipate and regulate for them in advance.

2. Context

2.1 That there is a level of dissatisfaction with various aspects of the operation and administration of the Code is not in question. Dissatisfaction with the provisions of the Code can be addressed currently by way of Code amendment proposals from those who feel aggrieved. On the other hand, NGPAC itself should address, so far as is practicable and without further delay, the administrative issues relating to the Code and NGPAC processes as part of its functions under 9.4 of the Agreement. NGPAC need not and should not wait for the Review to tell us this. There are, however, some matters the resolution of which may involve important policy, even constitutional, issues.

2.2 The main areas of dissatisfaction that have arisen in connection with operation and administration of the Code processes (as distinct from its substantive regulatory policy provisions)seem to be:

2.2.1 The slow and complex Code change procedure.

2.2.2 The role assumed by regulators in applying the Code (seen by some as too intrusive and prescriptive).

2.2.3 The apparently inappropriate membership of NGPAC to address policy matters; principally that regulators should not participate in the formulation of policy they will later apply.

2.3 Some service providers claim that the overall effect of these perceived shortcomings, together with some continuing confusion about potential conflict between outcomes under the Code as opposed to Part IIIA of the Trade Practices Act, add up to unnecessary cost and sovereign risk.

2.4 User stakeholders complain that the regime does not yet provide a level playing field in terms of availability of information and hence bargaining strength.

2.5 Regulators, perhaps unsurprisingly, complain of insufficient powers with which to discharge their current view of their respective roles.

3. Intentions v Outcomes

3.1 I have given thought to and consulted with various stakeholders about the causes of the dissatisfaction (rather than judge whether their concerns may be justified).

3.2 My general conclusion is that, from the outset, there has been a misalignment of expectations among some key stakeholders. This in turn may arise from lack of clarity at best, and lack of agreement at worst, about the original policy intentions of the gas pipeline access regime.

3.3 The regime can be characterised as operating at four levels: (i) policy formulation and setting (by jurisdictions), (ii) Code administration (by NGPAC), (iii) Code application (by regulators) and (iv) market development behaviour of commercial stakeholders (both service providers and users). In my submission there is a lack of clarity and perhaps agreement about original policy intentions both horizontally and vertically: that is, both within and between these four operating levels.

3.4 At the policy setting level, the original intentions are captured in the Competition Principles Agreement and the CoAG Agreement. It could be said that the policy basis for the regime includes broadly, economic, industry, energy, and infrastructure and competition policy. I do not recall and cannot find any reference to consumer protection policy as part of the basis for the regime.

3.5 In the debate leading to the regime (including the Hilmer Report), the agreed themes were about encouragement and facilitation of :

3.5.1 Access to energy infrastructure by Australian industry to enhance its "competitiveness" and the development of markets upstream and downstream of the infrastructure facilities;

3.5.2 Investment in such infrastructure to encourage development of national markets for both energy (gas) and the necessary transmission and distribution services;

3.5.3 Prevention of abuse of monopoly power and the encouragement of commercial outcomes; and

3.5.4 Negotiated commercial outcomes, with provision for resolution of disputes.

3.6 Achievement of these outcomes would also achieve equity, in the form of lowest sustainable prices, for the end consumers.

3.7 As stated above, this paradigm was seen as appropriate, particularly for gas as distinct from electricity, since some of the important infrastructure was already privately owned, with more to follow swiftly.

3.8 But traditionally, for many Ministers and their advisers at the time, a mention of "competition policy" went hand in hand with consumer protection. This was reflected in overlapping legislative and regulatory approaches to these subjects in the several jurisdictions. So the "hands on" role assumed by regulators in applying the regime did not immediately strike policy makers in the jurisdictions and/or regulators themselves as inappropriate in its detail.

3.9 Even commercial participants, early in the regulatory process, responded as seemed to be expected of them by regulators. Pretty soon all stakeholders found themselves operating a regime that did not seem to reflect what many had anticipated from their involvement in its setting up.

3.10 It is worth repeating that many stakeholders hoped that the process would involve service providers proposing "vanilla flavour" terms of access, with detailed negotiations among the major players filling in the gaps in the case of specific arrangements, the regulator applying a "touch on the tiller" as necessary and resolving disputes. What quickly emerged was a comprehensive price setting process drawing more on regulatory theory and practice than on commercial negotiation and market oriented behaviour.

3.11 Determining whether or not this is a fair representation of what happened may be appropriate for the Review to pursue, but it clearly also falls within the NGPAC remit (see 9.4(a) of the Agreement).

3.12 If this is indeed a fair summary, then its main cause may be what I have referred to above as the "horizontal" lack of policy clarity: that is, the unintended development of a

significant consumer protection flavour to the application of the access regime rules (the Code). Why this occurred, virtually unchallenged, is another question. An aversion to risk by all stakeholders seems to be at least part of the cause. For example both service provider and user managements, entering unknown territory, sought as much certainty as was available about the respective future income streams and costs relating to their infrastructure assets and services. After all, their Boards, customers and financiers could all be relied upon to press for such certainty. My observation is that at least some stakeholders appear to have looked to the regulators to provide that certainty. The regulators responded in the way they had habitually acted in response to their traditional or departmental remits – which in many cases place emphasis on price justification and setting, rather than encouraging commercial negotiation.

3.13 So my thesis perceives the "horizontal" lack of clarity at the policy setting, Code application, and commercial stakeholder levels.

3.14 In 2.1 and 3.11 above, I postulate that NGPAC could and should have been monitoring these developments and reporting on them and indeed advising Ministers on possible solutions. A possible reason why has this has not occurred to any great extent may lie in the "vertical" plane. That is, various NGPAC voting members (i.e. jurisdictions) have shown a reluctance to pursue solutions to perceived regime inadequacies through the prescribed vertical chain of stakeholder consultation, NCC comment, NGPAC recommendation, through to ministerial endorsement and often legislative amendment. The source of this discomfort seems to have been based both on: (a) the process formally requiring a recommendation from NGPAC (with is non-government as well as government members) before any minister or jurisdiction could amend the Code; and (b) the inclusion among the membership of NGPAC of the Regulators, in particular, who would administer any such changes.

3.15 In this context it should also be added that, over time, the inherent internal conflicts of interest among NGPAC members have not been resolved, and in some cases have blossomed. Infrastructure and market development needs still differ among the various jurisdictions and non-government stakeholder representation has become more complicated. For example, when the Code was being negotiated, there was very little opportunity for direct competition among and between transmission and distribution service provider member organisations such as AGA and APIA. This has changed.

3.16 There was early recognition that within as well as between each category of NGPAC members, there existed real and potential conflict of interest. Hence NGPAC recruited a panel of independent expert consultants. There has been, however, considerable reluctance from among its members, particularly some jurisdictions, to resource NGPAC

(not least financially) sufficiently to achieve an independent capacity to analyse identified issues and to propose nationally uniform and consistent solutions (Code change and other). “Capacity” in this context would include commitment of the intellectual and policy clout to analyse and resolve issues and should not be taken to imply a need for permanent staff. Although with only a non-executive Chair, a part-time Program Manager and a part-time Executive (administrative) Officer, NGPAC seems pretty lean for the body charged with setting the rules by which the income of billions of dollars worth of infrastructure is regulated.

4. Re-focussing of Policy Intent

4.1 Whether or not my characterisation of how we got to this situation is correct, I strongly believe that any analysis by the Inquiry should include consideration of a re-focus of the policies which underpin the regime. Otherwise confusion and resentment among stakeholders will persist. It would seem entirely proper for relevant jurisdictions to provide guidance to regulators to undertake their respective roles in applying the Code in a manner consistent with a primary focus on competition policy, as opposed to consumer protection policy, with the latter policy’s overlapping but different set of stakeholder interests being catered for by appropriately constituted and targeted regulators.

4.2 There needs perhaps to be a re-statement of the principle that applying the Code is a discrete task related to this access regime – not an extension of the generally accepted role of the regulators under their respective parent legislation (which may include consumer protection).

4.3 At very least, such a re-focussing would ensure that any unintended policy setting influences could be removed from future application of the regime. Jurisdictions would have the opportunity to thereby address concerns, expressed to me by service providers in particular, about a perceived growing sovereign risk arising from the application of the regime.

4.4 In this context it is worth recalling that among the circumstances leading to the Competition Principles Agreement were the dysfunctional market distortions produced by the previous approach of utility price regulation. Many of these distortions were produced in the name of consumer protection.

5. Way Forward

5.1 It is not appropriate for NGPAC to await the outcome and recommendations of the Inquiry before addressing at least the pressing issues within its remit. Some of the means

to achieve resolution of perceived shortcomings of NGPAC's performance and regime deficiencies are already available. For example:

5.1.1 NGPAC has the ability to determine its own procedures – Agreement 9.4. So far, apart from meeting arrangements, these have been focussed on just one of the four specified functions, namely 9.4(d) – Code change. NGPAC could be more proactive and take more initiative in the use of its procedures in finding ways to implement its intended role.

5.1.2 There is no impediment to NGPAC adopting procedures to establish, at the appropriate level of representation in each case, various working groups, under the auspices of the Agreement and within the umbrella of NGPAC, to undertake the functions set out in 9.4.

5.2 For example, a high level "policy" advisory panel comprising only jurisdictions and industry representatives (overcoming the objection of including regulators in policy setting debate) could be formed to deal with matters referred to in 9.4(a) & (b). A working group with a different level of individual membership could deal with Code change proposals, taking policy guidance as appropriate on how to proceed and with what priority from the work of the policy panel. The composition and remit of such panels and working groups would need to be the subject of separate and detailed proposals to NGPAC from within its membership.

5.3 This is but one example of how to get more out of NGPAC for the benefit of the operation of the regime. A number of other and different initiatives could be readily developed, by NGPAC itself, given an appropriate level of commitment by stakeholders to adopt an "outcome", rather than a purely "process" approach towards NGPAC involvement.

5.4 These points concerning NGPAC's remit and authority to take action, as opposed to its modest achievements so far, are raised at this Inquiry as a reminder that merely streamlining the Code administration arrangements may not produce the desired results. Without re-focussing on, restating and where necessary re-defining the desired outcomes, all that will result is a more efficient process achieve to some of the same unwanted outcomes and frustration. In proposing the role for any successor entity to NGPAC, the Inquiry is urged to take the foregoing into account.

6 Achievements

6.1 So far I have dwelt on "perceived shortcomings". The phrase was not randomly chosen. Apart from the favourable opinion of the NCC (eg see its submission to the PC's more general review of access regimes), a number of other stakeholders do not see the regime

as essentially deficient, nor NGPAC as being in need of radical surgery. Most, however, believe Code administration could be performed at a higher level, whether by NGPAC or other existing or indeed new entity.

6.2 We have a national, uniform regime, much less complex than that for electricity. Considerable new investment in infrastructure has taken place since its introduction. I am not aware of any significant project which has foundered on the shoals of regime shortcomings alone. Neither am I aware of any case where perceived regime shortcomings constituted a significant factor in a project not proceeding.

6.3 The regime currently contains the flexibility to encourage commercial stakeholders to negotiate, within the framework of the regime, appropriate commercial access arrangements.

6.4 NGPAC has managed a cumbersome system of Code change cost effectively, albeit slowly. Its membership includes all appropriate stakeholder interests – perhaps a wider range than traditional public administration practice would comfortably embrace.

6.5 There is now an experienced, growing and increasingly expert cadre of officials, executives and consultants able to administer the uniquely Australian access regime requirements – even if there remains some constraints to full realisation of the undoubted potential due perhaps risk aversion and lack of role clarity.

7 Timing

7.1 In the view of a number of stakeholders, including some jurisdictions, the regime "ain't broke" and therefore might not otherwise attract sufficient attention and priority to warrant the Ministerial attention necessary to implement change. At the same time, clearly all is not well and improvements can always be made.

7.2 The importance of NGPAC addressing its the effectiveness in fulfilling its remit at this time lies in the likely timeframe within which the Review will be completed and, more to the point, unanimous agreement (see Agreement 9.6) among jurisdictions is reached on implementation of its conclusions and those which may be picked up from the Parer review. In the meantime NGPAC has a duty to fulfil both in improving its own performance and in ensuring that the Review has a clear field of vision. That is, the Review should not have to waste time and risk dilution of focus and effort, bothering with matters which NGPAC could and should fix within its present capacity and remit.

7.3 Experience and observation also suggest to me that we now have a time window during which the gas access regime will appear on Ministerial radar screens. The window is likely to open with the conclusion of the Inquiry and then close (quite appropriately) until at least after the next round of Access Arrangement assessments. It has therefore been an

important part of my recent round of consultations with stakeholders to ensure that, at the highest level they are aware of this time window. They have also been encouraged to take advantage of this Inquiry and the consequent time window of focus to achieve a better regime, perhaps through a stronger nexus between the policy foundations and the application process.

8 Conclusions

8.1 Regardless of the outcome of the Inquiry, and until there is action based on its recommendations, NGPAC has the obligation, the remit and the tools with which to improve its performance in dealing with the issues as they arise.

8.2 The Inquiry is urged to recommend a re-focus on and re-statement of nationally agreed competition principles as a basis for the gas access regime.

8.3 Bases on such principles, it is recommended that Regulators be given appropriately clear riding instructions on the discrete application of the access regime, leaving consumer protection issues to other, appropriate regulatory bodies.

8.4 Whichever entity is charged with the "administration" of the gas access regime, the Inquiry is urged to recommend its proper resourcing, including funding.

8.5 Any new entity formed to administer the regime should continue to include appropriate service provider and user stakeholder representatives at least in a consultative, if not voting, capacity. Its membership should be chosen to ensure is has credibility with the jurisdictions as being appropriate to its role. The question of Regulator membership may need to be addressed.

8.6 Most importantly, the new entity and the principles and policies it administers, should be directed towards promoting commercially negotiated outcomes among commercial stakeholders.

Greg Harvey

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