

National Competition Council

Submission in response to
the Productivity Commission's
draft report on the
review of the
National Gas Access Regime

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Overview

The Council supports many elements of the Productivity Commission's draft report on the *Review of the Gas Access Regime*. Some rebalancing of the regime through a greater emphasis on economic efficiency, added flexibility and the adoption of more timely processes could reduce the regulatory burden on service providers and users, contribute to administrative savings and efficiencies, while ensuring that the code does not hinder the efficient development and operation of gas pipeline services. The Council supports the following findings and recommendations.

- Remove the health and safety criterion from the coverage criteria of the National Third Party Access Code for Natural Gas Pipeline Systems (the Gas Code) (6.3).
- Retain the 'not be contrary to the public interest test' in the coverage criteria of the Gas Code (finding 6.6).
- That after lodgement of a part IIIA undertaking, the ACCC's assessments be held over pending a coverage assessment (6.8).
- That the NCC's recommendation on coverage is agreed in the absence of a Ministerial objection within 21 days (11.2).
- Limit the scope of the material that can be introduced to the appeal body under s. 38 of the Gas Pipelines Access Law to the material that has already gone before the primary decision maker (11.6).
- Make the same agency responsible for recommendations on coverage and the form of regulation (finding 12.3).

The Council sees merit in the Commission's recommendations to provide clearer direction on the intent of the Gas Access Regime. The adoption of a single overarching objective to assist decision makers and regulators will improve clarity and transparency and greater consistency in the application of the Gas Code.

The Council supports initiatives to provide greater flexibility in the Gas Access Regime. There is merit in developing an alternative to the current compulsory access arrangement process for covered pipelines. The Council would support a price monitoring regime as the alternative so long as it includes an enforceable right of access such as a binding dispute resolution mechanism. Such an approach could provide a sufficient discipline on service providers to provide

access on reasonable terms and conditions and would be warranted where it is less costly than the current approach to price regulation.

There is little evidence indicating that the coverage assessment is deficient and, moreover, significant changes risk creating considerable uncertainty. Consequently, the Council does not agree that there is a need to raise the threshold tests for coverage in order to apply the current access arrangements or alternative forms of regulation.

The coverage criteria are designed to balance the interests of investors in pipeline infrastructure with those of competitors in upstream and downstream markets and consumers. The process provides safeguards through an open and transparent assessment process. Under the current criteria a gas pipeline is covered only where it is likely to have a material impact on competition in upstream and downstream markets. The decisions of the Minister and the regulator are open to review to ensure regulation applies only where it is determined to promote the public interest. These features of the process minimise the risk of over-regulation. Given the complexities involved with access regulation there will always be some uncertainty associated with the process. The uncertainties, however, have diminished over time as service providers, users, regulators and other interested parties have become familiar with the regulatory system and the meaning and interpretation of the Gas Code.

A body of legal authority has developed from decisions in relation to national access regime (part IIIA of the TPA) and the Gas Code. The two regimes are complementary and experience and precedents developed in one can be transferable to the other. Even well-intentioned changes risk introducing new uncertainty and significant delays.

There is not strong evidence that access regulation is reducing investment in the gas transmission industry or that the risks associated with third party access regulation substantially add to the significant commercial risks associated with investment in essential infrastructure. There is, however, a strong interest in developing new gas resources in Australia and competition is emerging through the construction of new transmission pipelines and greater interconnectivity in Eastern Australia. It is important to recognise that reducing the investment risks for transmission asset owners will have implications for development of upstream gas resources and downstream use of gas. A principal purpose of the access regime provided in the Gas Code is to ensure that developments in these areas are not constrained by inappropriate restriction of competition by transmission bottlenecks. A reduction in the efficacy of the access regime could stifle development in upstream and downstream markets.

Moreover, concerns about any detrimental impact on pipeline investment can be addressed through other means. These include improvements to the access

arrangements, better use of access undertakings and the provision of binding rulings on coverage.

In the Council's view rebalancing the interests of transmission asset owners with those of upstream and downstream interests is primarily an issue that should be addressed in applying the access arrangements to covered pipelines. The scope of coverage test should be revised only if an inherent bias in those processes were found.

Structure of the submission

This submission focuses on the findings and recommendations in the Commission's draft report that are relevant to:

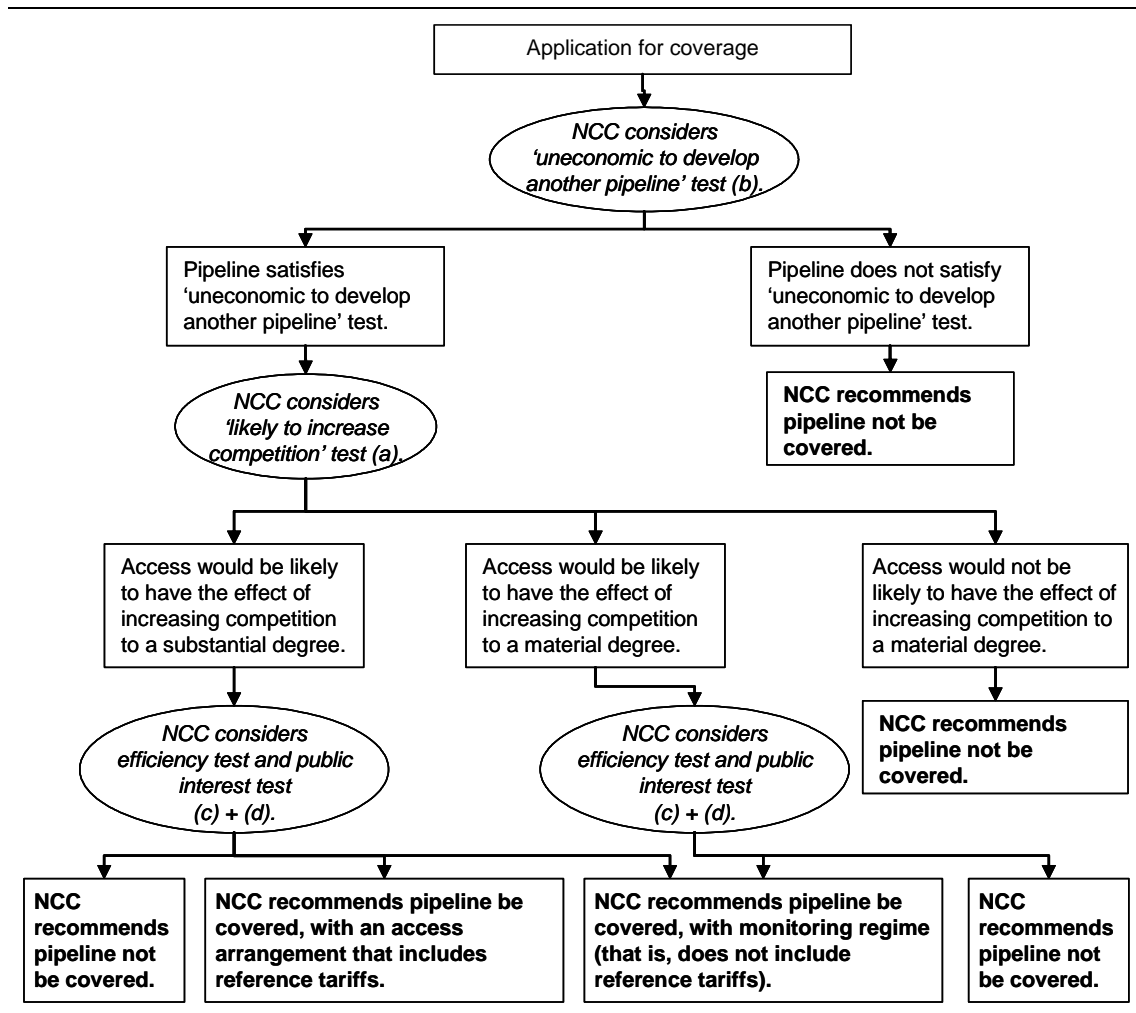
- coverage issues
- lighter handed regulation;
- binding rulings;
- coverage of a service versus a pipeline;
- a single objects clause; and
- merit review processes.

1 Coverage issues

The Council considers that the coverage process under the Gas Code is working effectively. The criteria provide for a balancing of the interests of pipeline investors and related businesses and consumers in upstream and downstream markets. While there may be some debate as to the appropriateness of coverage for some of the pipelines and distribution networks listed in Schedule A of the Gas Code, there is no evidence that since commencement of the Gas Code coverage decisions have occurred too readily or in cases where the gains are likely to be marginal. Consequently, with the exception of the recommendation on the health and safety criterion, the Council does not support a change in the threshold test for coverage (figure 1). It therefore does not support the Commission proposal for adoption of:

- a two-tiered approach to assessment under criterion (a) linked to a determination of two regulatory options:
 - access arrangements with a reference tariff, which could be applied only where access would be likely to have the effect of increasing competition to a substantial degree; or
 - price monitoring could be applied where access would be likely to have the effect of increasing competition to material or substantial degree; and
- a new efficiency test, which would become criterion (c).

Figure 1 The Productivity Commission’s proposed new framework for coverage decisions



Source: PC 2003, p. 192.

The Council does, however, support an element of the Commission's proposal albeit within the existing coverage framework. There is merit in expanding the regulatory options available under coverage where it can be demonstrated it will improve efficiency. Alternative regulatory options could be incorporated into the Gas Access Regime without altering the coverage criteria.

'Promotion of competition' test — criterion (a)

The Council does not support the Commission's recommendations to apply a tiered approach to threshold tests for coverage linked to determining the form of regulation to apply to covered pipelines.

Changes to the coverage criteria could be justified where there is evidence that the criteria are deficient. The evidence to date indicates, however, that the system is operating well. Moreover, the criteria are already framed in way that address the Commission's concerns. The Government determined that the decision to apply coverage should not be taken lightly. The requirements have an intended bias against a coverage decision. All criteria must be met. Where there are any doubts, the Minister cannot agree to cover a pipeline. All aspects of the potential benefits and costs, over the medium to long term, must be assessed and are open to a high degree of scrutiny. Participants have ample opportunity to present their arguments for or against coverage before and after the release of the draft recommendation. The Minister also has an opportunity to consider the matter further before making a decision. Any parties not satisfied with the Minister's decision may seek review by the Tribunal. These safeguards ensure coverage occurs only where the benefits outweigh the costs (including possible effects on investment).

The Council does not consider it appropriate for coverage, under the current access arrangements, to occur only where the benefits significantly outweigh the costs. The criteria are designed to permit a full assessment of the costs and benefits of coverage. It is appropriate to regulate pipelines where regulation would promote economic welfare. On this basis, the costs of modifying a well-understood regime are likely to outweigh any perceived benefits.

The Commission appears to overstate the potential costs of the Gas Access Regime. As the Council stated in the initial submission to this inquiry, the Gas Access Regime adopts a lighter handed approach than gas regimes in countries such as the United States and other regulatory regimes in Australia. The experience to date with the coverage and revocation processes is that the Gas Access Regime currently applies to significantly fewer pipelines, especially transmission pipelines, than anticipated by governments in the 1997 Natural Gas Pipelines Access Agreement. Implementation of the Gas Code has coincided

with strong interest in developing new gas resources in Australia and the construction of new transmission pipelines has provided significant interconnectivity in eastern Australia. Prior to construction investors in greenfields projects can obtain reasonable certainty from the ACCC as to the access arrangements that would apply to a pipeline once constructed. Consequently, there is little evidence to support a proposition that the Gas Access Regime is deterring investment in new transmission pipelines. Even if this were the case this is primarily a matter that should be addressed when determining access prices and other arrangements. Only if it is not possible to address the problem in that context should any systematic biases in the determination of access arrangements be considered a 'cost' that should be assessed as part of the coverage decision.

The Council sees little benefit from application of a substantial increase in competition test. The current criteria enable the costs of regulation to be fully accounted for in the coverage assessment. Coverage is imposed only where it is determined that it is likely to lead to a material improvement in the environment for competition. Regardless of any definition that might be developed to aid decision makers, the boundaries between something that is material and something that leads to a substantial improvement in competition would be difficult to discern. As noted by the Commission, analysis of imperfectly competitive markets is a complex task. It is difficult to distinguish between business behaviour that is competitive and that which is an exercise market power. Added to this, it is often difficult to quantify the likely impact on competition in any substantive way. By nature, coverage decisions require a forward looking assessment of the effects of coverage and the without coverage counterfactual. For these reasons the Council considers the Commission's proposal to be potentially unworkable.

Moreover, much of the legal precedent developed in the past few years from consideration of matters under part IIIA of TPA and the Gas Code has concerned the meaning and interpretation of criterion (a) — the *Sydney Airports* case¹ and the *Eastern Gas Pipeline (Duke)* case.² Thus, any substantial changes to the wording of criterion (a) risks introducing uncertainty into future coverage and revocation decisions. The Council envisages that raising the threshold test under criterion (a) for assessing coverage would result in increased disputes given the greater complexity of the analysis involved and likely differences in the distribution of benefits and costs that would arise under an access arrangement with reference tariffs compared to the lighter handed form of regulation the Commission proposes. This would have the potential to nullify much of the benefit to be gained from providing an additional regulatory option.

¹ *Sydney International Airport: Re Review of Declaration of Freight Handling Facilities* (2000) ATPR 41-754.

² *Duke Eastern Gas Pipeline Pty Ltd* (2001) ACompT 2.

Nevertheless, the Council recognises that there is some scope to improve the coverage criteria without the downside risks of uncertainty and added complexity. It considers that the Commission's objectives can be met by inclusion of a 'material' test into criterion (a) in line with the Government's final decision for the review of the national access regime. This is in accord with the current application of the Gas Code criteria by the Minister. It would also ensure consistency with the national access regime and meet the Commission's objective of ensuring that coverage is not afforded in cases where the promotion of competition is trivial.

Guidance in assessing the 'promotion of competition' test

The Council considers a range of matters when making coverage decisions under the Gas Code, including those suggested by the Commission in Box 6.5 (PC 2003, p. 179). Consequently, the Council expects Draft recommendation 6.2 — that the Gas Access Regime should be amended to give guidance on matters to consider in assessing the 'promotion of competition' test in coverage decisions — will have little practical effect. There are, however, a number of dangers from prescribing the matters in the manner suggested by the Commission.

First, the Commission has recommended an exhaustive list of matters to consider in assessing the 'promotion of competition' test. This would constrain the coverage analysis to those matters listed only. Accordingly, if the Commission proceeds with this recommendation, the Council suggests that an inclusive approach be adopted, similar to s. 50 of the TPA. Section 50 commences with the words 'without limiting the matters' to make clear that the ACCC may take into account other relevant matters in addition to those listed.

Second, listing the matters in 'black letter law' risks the need to resolve disputes over the statutory interpretation and weights that should be applied to the given factors listed. In *Re Dr Ken Michael AM; ex parte Epic Energy (WA) Nominees Pty Ltd and Anor* (2002) 25 WAR 511 (Epic decision), for example, the Supreme Court of Western Australia was required to resolve disputes over statutory interpretation with regard to:

- several factors the regulator was required to take into account including the owner's 'legitimate business interests and investment' in the pipeline; and
- the weightings that should be applied to the factors in decision of whether to approve the National Third Party Access Code.

New efficiency test

The Commission has recommended that that the coverage criteria in s. 1.9 should include a new test that coverage of a pipeline is likely to improve economic efficiency significantly. This proposal reflects the Commission's concern that the current double negative wording of the criterion might be applied where there is no or only minor improvement in economic efficiency. The Commission also noted that the case for an efficiency criterion is stronger for the Gas Access Regime coverage criteria than for the part IIIA declaration criteria because the Gas Code criteria do not have any threshold test for the significance of a gas pipeline. This latter contention ignores the requirements of clause 6(3) Competition Principles Agreement (CPA) and is therefore incorrect.

The Gas Code is certified as an effective access regime in New South Wales, Victoria, Western Australia, the ACT and the Northern Territory. One of the requirements of clause 6(3) of the CPA is that the regime applies to services provided by significant infrastructure. In determining that the Gas Code is an effective access regime under s. 44M of the TPA, the decision maker was satisfied that the infrastructure covered by the regime, including potential new pipelines that may come under the regime, met the significance threshold.

There is no requirement under the Gas Code that gas transmission pipelines or distribution networks be of national significance because the Gas Code deals with state-based infrastructure. State and Territory governments consider the role played by service providers in their local and regional economies. This is taken into account when making decisions on coverage. In the Moomba to Sydney pipeline decision, for example, coverage applies to those parts of the mainline that ensure effective access to the monopoly lateral pipelines servicing regional markets in New South Wales. The potential benefits of coverage in such cases may be relatively small from a national level, but are significant in the context of the relevant regional markets for the affected competitors and users in upstream and downstream activities.³

The proposed efficiency test appears to set the bar for coverage much higher than that for declaration. For part IIIA matters, declaration applies to nationally significant infrastructure. The test does not imply that the likely improvements in economic efficiency from declaration under part IIIA need to be greater than those from coverage under the Gas Access Regime. Rather, the size of the economic efficiency gain is determined by the significance of the dependent market(s) in which competition is promoted. Competition need only be promoted in one small upstream or downstream market to a material degree for the promotion of competition test to be met. As Ordovery and Lehr (2001) point out, criterion (a) might be satisfied if it were found to lower entry barriers in at least

³ The Moomba to Sydney pipeline system would likely meet the national significance for declaration under Part IIIA of the TPA.

one market, while increasing entry barriers in another. The latter is a matter relevant to considering whether declaration is not contrary to the public interest.

The proposed efficiency test unnecessarily replicates matters properly assessed under criterion (d) — that coverage should not be contrary to the public interest. While the Council may have regard to matters other than economic efficiency when assessing the public interest, the prime focus of the test is economic efficiency. In determining coverage the decision maker must be affirmatively satisfied that criterion (d) and all other coverage criteria are met.

Without evidence to demonstrate that a decision to cover a pipeline has occurred in marginal cases the Council can see no benefit in introducing a new test to guard against an unlikely event.

Determining the form of regulation

The Council supports initiatives to provide greater flexibility in the Gas Access Regime. There is merit in adopting an alternative to the current price regulation option where it can be demonstrated to deliver appropriate outcomes at a lower cost. The Council does not, however, consider that it is necessary to largely pre-determine the decision on the form of regulation that should apply by the assessment under criterion (a). The principles of good regulatory practice require a full assessment of the costs and benefits of regulation. Under criterion (a) the Council assesses whether access or increased access to services provided by means of a pipeline would have the effect of promoting competition in upstream and downstream markets only. At this stage, it is yet to be determined whether there are any other relevant considerations that demonstrate that coverage is not contrary to the public interest. It would, therefore, seem premature to exclude price regulation as an option for addressing the market failure before all relevant factors have been considered.

On this basis, the Council proposes that any decision about the form of regulation should be separate to and follow from the coverage decision and be determined on the basis of overall economic efficiency. The Council is in a good position to make an informed decision as to the appropriate form of regulation to recommend as the assessment against the full suite of coverage criteria would have a large bearing on any choice about the best form of regulation. Such an approach would also minimise implementation and adjustment costs by eliminating the need to alter the coverage criteria.

In determining the form of regulation the Council would consider matters such as ownership structures, the nature of competition in the market and demand characteristics. Where, for example, vertical integration is not an issue and there are a limited number of access seekers, it is likely that an alternative to the current access arrangements could operate effectively.

An alternative to the current approach to regulation would likely offer the greatest net benefits when applied from the outset of coverage, that is, when applied to pipelines that have not been previously subject to coverage. In such cases the costs of developing access arrangements with reference tariffs could be avoided. Nevertheless, the Council could see a role for using a lighter handed approach to regulation as a means to transition those covered pipelines, subject to access arrangements with reference tariffs, towards an open market. This could result from an application to re-assess the form of regulation or from applications for revocation. If the Council's assessment indicates that competitive conditions in the market are likely to improve over the short to medium term, a move to a lighter handed form of regulation may be justified on the basis of economic efficiency. Under such circumstances, participants in the market would already have the necessary information to negotiate access, even where the requirement on services to provide information to prospective access seekers is less onerous.

2 Lighter handed regulation

The Commission proposed that a price monitoring regime be available as a lighter handed alternative to regulation involving an access arrangement with reference tariffs. The Council is concerned with some of aspects of the Commission's specific design proposals for a price monitoring scheme. The Council does not support binding a decision in favour of price monitoring for a minimum period without some means to enforce the access rights granted by coverage because this approach is inconsistent with the requirements of clause 6(4)(c) of the CPA. It does not consider it is necessary to adopt a rigid approach by setting the minimum period of price monitoring at five years. Rather this should be determined on a case-by-case basis in line with the normal approach to coverage assessments under the Gas Access Regime. Further the Council does not support aspects of the Commission's recommendations relating to the implementation and review processes under the price monitoring regime. The Council would, however, support a modified version of the Commission's price monitoring regime that overcomes the Council's concerns.

A right of access

The Council cannot support the Commission's proposal that there should be no opportunity to apply for coverage with price regulation during the fixed minimum period of price monitoring. The Commission's current proposal for price monitoring may be appropriate when applied to an uncovered pipeline where the potential for declaration under part IIIA of the TPA provides an added

discipline on service providers. In the case of covered pipelines access seekers would have to rely solely on the threat that price regulation could be imposed at the end of the minimum price monitoring period as a means of deterring service providers from misusing their market power. This is a high risk approach.

Moreover, the Commission's current proposal does not meet the requirements of the CPA. In order for an access regime to be certified as effective, clause 6(4)(c) of the CPA requires the access regime to include a means to enforce the access rights granted by coverage.

For these reasons the Council considers that it is essential for any price monitoring regime operating under the Gas Code to include a mechanism for resolving access disputes. The Council favours modifying the obligations proposed for the price monitoring regime to include an arbitration process through use of an independent binding dispute resolution mechanism. It also considers that it is a necessary requirement for a workable model that arbitration be funded by the disputing parties so as to provide an incentive to achieve commercially negotiated outcomes. Where access seekers and service providers cannot agree on an appropriate way to resolve their dispute within a reasonable period of time, the regulator should invoke the default dispute resolution option under the Code.

The period of coverage

The Council agrees with the Commission that when price monitoring is applied it should apply for a fixed minimum period (*draft rec 6.7*). The Council also agrees that the minimum period should be set to offer sufficient oversight to protect the interests of access seekers, while encouraging the parties to engage in meaningful negotiations over the terms and conditions of access. The Council considers, however, that the minimum period for price monitoring should not be pre-set for some arbitrary term.

The Council considers that the minimum period of price monitoring should be determined on a case-by-case basis. A flexible approach should be adopted where access seekers or service providers are free to request the period of time for which coverage with price monitoring might apply. Such an approach is more in line with the existing coverage and declaration processes where the Council assesses each application on its merits. In making recommendations to the Minister, the Council should have regard to any information supplied by interested parties on the matter, but have the discretion to apply price monitoring for a period that is greater or lesser than sought by the applicant after taking into consideration all relevant matters.

Responsibility for implementation

The Council considers that it is important to have separate bodies responsible for recommending price monitoring and for implementation. Separation of the policy and regulatory functions avoids problems associated with a regulator determining its own jurisdiction and imposes few, if any, costs of inconsistency or overlap between the two responsible organisations. The Council understands that the Commission's proposal on these matters is consistent with the approach adopted in the Inquiry into the *Prices Surveillance Act 1983* (PSA), where the Commission recommended that the PSA be repealed and the TPA be amended to provide powers to undertake public inquiries and to implement price monitoring, based upon defined indicators nominated by the inquiry (PC 2001a, p. 91).

The Council is a small organisation with dedicated expertise in policy analysis and advice. Its coverage decisions are concerned with broad policy issues such as identifying natural monopoly infrastructure and analysing current and prospective competitive conditions in relevant markets. Conversely, determining what information a service provider should disclose for the purpose of monitoring its prices involves analysis of specific access prices and underlying costs, asset valuations, depreciation, rates of return and prices as well as a range of requirements for the actual provision of third party access. This is a task normally undertaken by the regulator. The Council considers that the ACCC is the appropriate body to undertake this task.

The ACCC has extensive experience with prices monitoring and the development and publication of supporting guidelines. It monitors prices in some highly complex industries in diverse areas such as airports, petrol, postage services, telecommunications and waterfront and shipping.⁴ Taking advantage of this expertise would help to minimise the administrative costs of establishing a price monitoring system for coverage under the Gas Code. It would also ensure that the appropriate indicators are monitored and reported on, and would assist with achieving consistency of regulatory approaches across industries.

The Council agrees that any guidelines should be developed through a consultative process that is open and transparent and includes submissions from interested parties. This should help to ensure that appropriate information disclosure requirements are settled at the outset and kept to a minimum. Disclosure requirements should not be altered during the monitoring period.

The Council considers that there is some risk of 'regulatory creep' whereby information requirements become more onerous with time. The Council considers that the risk of this in regard to price monitoring under the Gas Code is limited. Arrangements in the gas transport services are not highly complex

⁴ See <http://www.accc.gov.au/content/index.phtml/itemId/3671>.

and there is a limited range of ancillary services. Therefore it is unlikely that the price monitoring requirements would need frequent updates. Nevertheless, if the Commission is concerned about this issue it could require the price monitoring guidelines to be included into the Gas Code.

Review of coverage

In circumstances where price monitoring is applied, the Council supports the Commission's proposal to place no restrictions on applications for revocation. Coverage should apply only where it is needed to address a market failure. It would also be appropriate to allow only the regulator to apply to the Council to impose regulation via an access arrangement with reference tariffs (at expiry of the minimum price monitoring period). The Council considers, however, that the regulator should apply to the Council only where the price monitoring data indicate that the service provider has been exerting market power and it is acting on a complaint from an access seeker.

The Council considers that the Commission should give consideration to what should happen after the expiry of the minimum price monitoring period in the event that the Council does not receive an application or has not completed the assessment of coverage or revocation. The Council's experience since the commencement of the Gas Code is that there often are considerable delays in receiving an application for coverage or revocation. Moreover, the process itself can be drawn out, sometimes taking up to a year, in circumstances where applicants seek review of the Minister's decision in the Tribunal.

The Council proposes that prices monitoring should remain the *default position*. That is, price monitoring should continue to apply until such time as an application has been considered by the Council and a decision made by the relevant Minister (upon application) or Tribunal (upon an application for review) — whether it be a decision to change to price regulation (the result of an application from a regulator) or to revoke coverage (the result of an application from a service provider). This should ensure consistency in the application of regulations. It would also be administratively simple and provide certainty to service providers and other affected parties.

3 Binding rulings

Draft recommendation 9.1 proposes that the Gas Access Regime be amended so that the Council, on request from a potential pipeline investor, can provide a binding ruling on coverage.

The Council supports the provision of binding rulings for no coverage as a means to reduce regulatory risk by providing certainty with regard to coverage, but considers that a more flexible approach than that proposed by the Commission should be adopted. The Council considers this to be particularly important given that any alterations to the Gas Code in this regard could also have implications for part IIIA of the TPA (*Government Response to Recommendation 11.1 of PC Review of National Access Regime*).

The Council notes the Commission's acceptance of the CoAG Energy Market Review proposal that a 15-year ruling would balance the need to provide pipeline owners and operators with certainty, while giving potential new pipeline users some rights of regulatory assistance in gaining later access (PC 2003, p. 285).

As noted in the Council's initial submission to this inquiry, whether this period is the right length to 'deliver appropriate returns on investment' is a regulatory question that does not fit well within the framework of the coverage process. The Council sees the binding ruling process having particular application in situations where:

- it is unlikely that the pipeline will have natural monopoly characteristics and, as a consequence, it is unlikely that criterion (b) will be satisfied; or
- the market conditions are such that it is unlikely that criterion (a) will be satisfied, for example, because the pipeline owner is not ever likely to possess market power.

The Council submits that the fixed '15-year or nothing option' does not recognise the difficult issues that need to be considered in relation to any given application on the facts of the market in which it is placed. Sufficient certainty may be achieved for some pipelines within much shorter timeframes, and therefore the Council should have flexibility to determine the length of the binding ruling period. The CoAG Energy Market Review alluded to the provision of some flexibility when it stated — 'in making an application for a binding ruling, companies can propose the period of the binding ruling' (CoAG Energy Market Review 2002, p. 55).

Under the current system of coverage, the Council, and the Minister, have the flexibility to determine coverage to a greater or lesser extent to that sought (sections 1.9 and 1.13 respectively). The Council considers that it would be appropriate for an application for a binding ruling to be treated in a similar way to a coverage application, with the period of the binding ruling determined on a case-by-case basis. The Council considers that this would lead to a more practical and effective binding rulings system based on the circumstances of the pipeline, the market it competes in and the state of the gas industry generally at the time of the application.

For those investments that do not meet the criteria for a binding ruling of no coverage, the Gas Access Regime provides pipeline investors with an option to submit an access arrangement to the regulator and have it approved prior to investment. The Council considers that this is more likely to offer certainty for investors than a binding ruling on coverage with price monitoring where there is potential for the access arrangements to be altered after the expiry of the minimum price monitoring period.

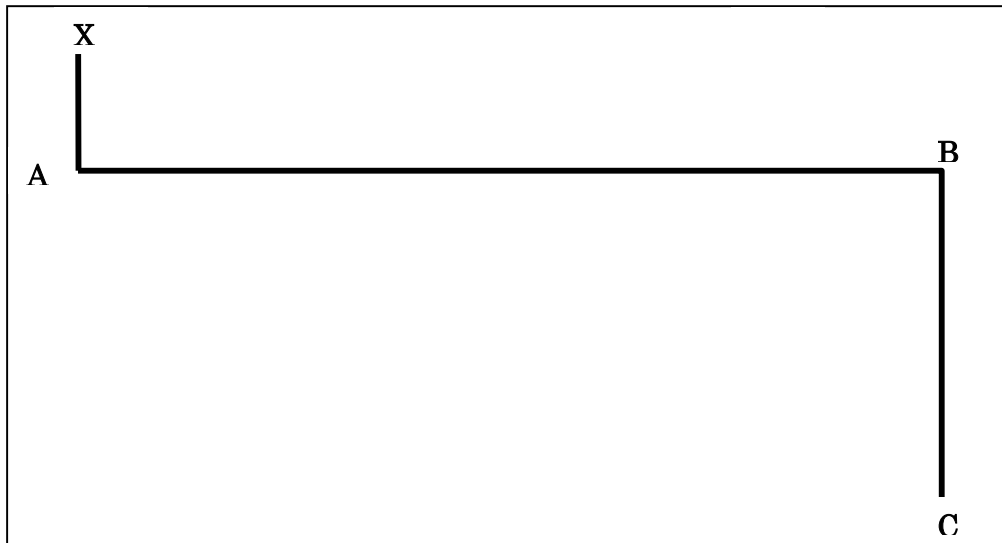
4 Coverage of services versus pipelines

Unlike part IIIA of the TPA, the Gas Code provides for coverage of physical pipelines rather than specific services provided by pipelines. The access arrangements, therefore, apply to the whole suite of services provided by the owner of the covered pipeline. This approach to regulation potentially captures a greater scope of services than is necessary.

To date, this issue has not been subject to significant consideration. The primary reason for this is that in almost all cases of coverage and revocation, the competitive environment for the entire suite of services offered by a pipeline has essentially been identical. The Council and the Tribunal have largely concentrated on point-to-point gas haulage services in applying the coverage criteria (see Duke decision). The presumption has been that if the coverage test is satisfied in respect of the principal pipeline activity of gas haulage between two points, it would be satisfied in respect of other services provided by that pipeline.

The Council anticipates that the situation may change as more competition emerges, such that competitive conditions may differ across the services offered by pipeline operators. The point is illustrated using figure 2. In this scenario B is a competitive market able to source gas from both points A and C. Market X, on the other hand, is dependent on the A-B pipeline for all supplies of gas into the spur line. A key objective of coverage under the Gas Code is to promote competition for the supply of gas to the downstream market at point X. For this to occur, C must have access on reasonable terms to the entire main A-B pipeline. Regulation to ensure this outcome would be appropriate.

Coverage of the A-B pipeline would, in addition to addressing the bottleneck problem faced by C, also enable A (but not C) to seek regulated terms of access for the supply of gas to B, even though B is a competitive market. Alternatively, if the Gas Code provided for coverage of services rather than a physical pipeline, access arrangements could be limited to the backhaul service required by C to supply gas to the market at X. In this way, overregulation would be avoided.

Figure 2: Pipeline network representation

Coverage of services may, however, require some consequential amendments to the Gas Code such as clarification of the service definitions within the Gas Code. Under the current definitions it is unclear whether services can be isolated from one another for the purposes of regulation. Would the definitions, for example, allow separation of backhaul haulage services between two points from the forward haulage service between the same two points? Another issue that arises is that the Gas Code not only provides for the regulation of terms and conditions of access, but also the physical pipeline itself. Here, the ring-fencing provisions provide an example.

Given that such issues are not insurmountable, the Council sees merit in moving toward a regime of coverage of services provided by pipelines rather than physical pipelines themselves, particularly in an environment of network expansion and increased competitive complexity. Coverage of services rather than pipelines would also sit more comfortably with the focus of the Commission's proposed objects clause and access arrangements, which both focus on services provided by pipelines rather than the physical pipeline itself.

5 Single objects clause

The Council supports the inclusion of a single overarching objective in the Gas Access Regime. The main aim of access regulation is to promote economic efficiency and this should be the focus of an overarching objective for the gas access regime, consistent with the approach the Government has accepted for part IIIA of the TPA.

The Council considers that consistency between the national access regime and the gas access regime is important to providing certainty and minimising regulatory risks associated with access regulation.

It therefore considers that as far as possible the overarching objective for the Gas Access Regime should mirror that of part IIIA of the TPA. In this regard the Council proposes that the Commission recommend that the overarching objective for the Gas Code be consistent with objective (a) of the Government's final response to the review of the national access regime, that is:

- to promote the economically efficient operation and use of, and investment in, the services of transmission pipelines and distribution networks, thereby promoting effective competition in upstream and downstream markets.

The Council expects that consistency between the overarching objectives of the two regimes will offer the greatest certainty for infrastructure owners, access seekers, investors and other interested parties, and will provide clear, transparent and consistent guidance to decision makers. An emphasis on promoting 'effective' competition makes clear that a pragmatic solution is sought and retains a direct link to clause 6(1) of the CPA.

6 Merits review

The Council supports draft recommendation 11.6 to limit the scope of material that can be introduced to the appeal body under s. 38 to material that has already gone before the primary decision maker. There would, however, be merit in providing a limited exception for new material that is essential to a proper consideration of the coverage or revocation decision, but was not available at the time (as opposed to simply not supplied) the Council made its recommendations.⁵

The Council considers that the approach outlined above offers flexibility, while reducing the scope for regulatory gaming or opportunities to delay the coverage and revocation process. It should also contribute to greater uniformity in the decision making process and improve certainty for affected parties.

⁵ This would ensure that all applications can be properly considered rather than requiring parties to re-apply to the Council where new information could materially alter the decision.

References

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