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

Dear Mr Hinton

This letter provides the South Australian Government's views in response to the Productivity Commission's Draft Report on the Review of the Gas Access Regime (the Regime). This follows the Government's initial submission to the Review, provided in September 2003.

Objectives and objects clause

The South Australian Government concurs with the Productivity Commission on the need for an overarching objects clause, as proposed in Draft Recommendation 5.1. The Government, however, has concerns regarding the proposed clause. Primarily, the clause combines closely related objectives with an anticipated, but not certain, outcome. These matters should be set out as separate parts of the objects clause.

Any overarching objects clause should recognise the role of the Regime to provide a national approach to third party access to pipelines. Also as currently provided in the South Australian *Essential Services Commission Act* 2002, protection for the long-term interests of consumers should be included. Such an objective would make it clear that consumer interests remain pivotal to the regime and ensure that the regime will continue to prevent the abuse of monopoly power.

South Australia suggests that the following alternative overarching objects clause be incorporated in the Regime:

The objective of this regime is to establish a national framework for third party access to gas pipelines that:

- ***promotes investment in natural gas pipelines and related facilities, and their economically efficient use;***
- ***promotes competition in upstream and downstream markets; and***
- ***protects the long term interests of Australian consumers.***

Draft Recommendation 5.2 proposes the deletion of certain objectives from the Regime. South Australia agrees with Draft Recommendation 5.2, subject to acceptance of the alternative overarching objects clause proposed above.

The South Australian Government is opposed to section 2.24(e) being deleted, as proposed by Draft Recommendation 5.3. It would be contentious to create a situation in which a Regulator, faced with a dilemma, would be unable to have regard to the public interest.

Section 2.24(e) in its present form does not enable a Regulator to pursue specific public interest objectives selected by the Regulator. It is seen more as a provision that enables a Regulator to take account of the public interest when other considerations are finely balanced, or to not act in a manner that is strongly in the interests of a particular party but clearly contrary to the public interest.

Consideration should be given to rewording section 2.24(e) to bring it into conformity with the view of the public interest set out above.

Facilitating capacity trading

In its initial submission to this Review, the South Australian Government favoured an examination of whether it is appropriate to require a public register of spare capacity for each transmission pipeline irrespective of the level of spare capacity that existed at the time the access arrangement was submitted.

The South Australian Government reiterates its support for information regarding unutilised pipeline capacity being publicised and considers shippers posting such information on their websites to be an appropriate measure.

The Government does, however, consider that Draft Finding 7.4 should be more strongly worded and would be better formulated as a recommendation as follows:

The Gas Access Regime should be amended to require Service Providers to facilitate capacity trading by posting information on their websites regarding unutilised capacity that shippers want to trade.

The South Australian Government supports the introduction of use-it-or-lose-it rules for unutilised contract capacity.

Use-it or lose-it rules would provide a mechanism for decreasing a shipper's right to contracted capacity if the shipper does not use it at a certain level and does not seek to trade that capacity. The rules should encourage shippers to trade (bilaterally or through an electronic bulletin board) unused capacity, rather having their unutilised capacity arbitrarily allocated to a third party under the use-it-or-lose-it rules. The purpose of such a provision is to encourage accurate capacity nominations and full pipeline utilisation, and prevent hoarding of pipeline capacity by shippers.

The pipeline operator could have a role in facilitating such capacity trades by matching access seekers with capacity posted on a bulletin board, provided shippers make available sufficient information on terms and conditions. Another approach is for shippers to relinquish unutilised capacity to the pipeline operator, to be resold to an access seeker, with the shipper being relieved in part from the contract and its obligation (including payment obligations).

The use-it-or-lose-it rules would only come into operation where a shipper does not actively trade its unused contracted capacity through established capacity trading mechanisms. The shipper would have its unused capacity re-allocated to another shipper. A shipper with unused contracted capacity should be compensated for losing that capacity consistent with their willingness to trade unutilised contracted capacity as the Regime sufficiently provides the shipper with prior opportunity to enter into a commercial trade.

The South Australian Government is of the view that use-it-or-lose-it rules should be introduced and be structured in such a way that they provide an incentive for shippers to trade their unused contracted capacity in the market. Particularly, the level of a shipper's willingness to trade its unused capacity should be a factor in determining the compensation payable to the shipper for losing its unused capacity under the use-it-or-lose-it rules.

Coverage

The Productivity Commission's Draft Recommendations include increasing the threshold test for coverage. The implication of the coverage test proposed by the Commission appears to be that fewer pipelines would be covered by the Regime, or at least no more than at present.

The South Australian Government has now arrived at the view that the regulatory costs of an 'all in' model would be likely to outweigh the transactional costs that could be incurred in disputes regarding coverage within the coverage framework proposed by the Commission. Consequently, the Government is no longer advocating the 'all in' approach to coverage presented in its initial submission to the Review. The Government supports the Regime continuing to provide for uncovered pipelines.

The concept of some pipelines being subject to lighter handed regulation than others was reflected in SA's earlier submission to the Review. The Government is in favour of the introduction of lighter handed regulation, in the form of the monitoring regime proposed in the Draft Report.

The tests proposed in Draft Recommendation 6.6 for determining the form of regulation for a covered pipeline would appear to be very difficult to apply. The potential for litigation concerning the interpretation of increasing competition to a 'material' degree as opposed to a 'substantial' degree, appears to be present in the tests.

The Government reiterates the concerns expressed in its earlier submission

regarding dual pathways for access regulation and agrees with Draft Recommendation 6.8.

The South Australian Government is opposed to an amendment to the Regime to the effect contemplated in Draft Finding 6.9. It may be that an unsuccessful access seeker's commercial interests do not compel them to apply for coverage, especially as it would signal their unsuccessful access attempt to the market. The public interest in curbing the exercise of monopoly power by Service Providers could see a need for other parties such as governments or user groups to apply for a pipeline to be covered by the Regime.

If Draft Finding 6.9 were to be implemented, it could be problematic for a party to demonstrate that it has undertaken 'best endeavours' in its negotiations with the Service Provider, with the potential for litigation.

Draft Recommendation 9.1 proposes binding coverage rulings being made by the NCC. The South Australian Government considers binding coverage rulings, including those in favour of lighter handed regulation, to be appropriate, however, the decision maker should be the relevant Minister. Binding rulings are essentially decisions as to coverage and such decisions should ultimately be the responsibility of Ministers, as recognised by Draft Finding 12.5.

The Government is of the view that Draft Recommendation 9.1 should be amended to provide that a binding ruling in favour of lighter handed monitoring should be for up to fifteen years, not five years as currently provided in that draft recommendation. Five years for a ruling in favour of lighter handed monitoring may not be long enough to provide an investor in a new pipeline with the degree of regulatory certainty required to make investment in the pipeline viable, particularly given the long duration of the economic life of a pipeline.

Fifteen years is an appropriate period for a binding ruling that pipeline not be covered.

Administrative and appeal processes

The South Australian Government supports in principle the first part of Draft Recommendation 11.1 and supports Draft Recommendation 11.4, which should result in more timely decisions.

The Government opposes the second part of Draft Recommendation 11.1 concerning the backdating of tariffs, as it could create regulatory uncertainty for Service Providers.

The Government opposes Draft Recommendation 11.3, as it would not be practicable without other changes being made to the earlier stages of the process of approving an Access Arrangement. This is because the "further final decision" is an essential step within the present process.

It is not clear from Draft Recommendation 11.3 what would happen after the Regulator has issued a final decision. The "further final decision" simply entails the approval, by the Regulator, of the changed Access Arrangement, to ensure that it incorporates the amendments specified by the Regulator in the Final Decision. It is difficult to see how this step can be avoided if the Service Provider is to draft the Access Arrangement. Draft Recommendation 11.3 ignores the fact that the first round of consultation is not about a decision of the Regulator, but rather a Service Provider's proposed Access Arrangement. There is, in fact, only one consultation on the Regulator's decision. There are not in effect 'two draft decisions'.

The merits review arrangements provided for by the Regime involve balancing the tensions between timeliness, cost and providing interested parties with natural justice. Allowing a full merits review of an Access Arrangement as envisaged by Draft Recommendation 11.5 would involve a reconsideration of the Access Arrangement in a lengthy and costly process. The public consultation undertaken in relation to an Access Arrangement should address natural justice concerns.

All Australian governments agreed to the current limitations contained in section 39 of the Gas Pipelines Access Law after considerable discussion as part of the process for the establishment of the Regime.

South Australia opposes Draft Recommendation 11.5.

Institutional arrangements

The Draft Report recognises COAG's work regarding the governance arrangements for energy markets. A number of decisions taken by the Ministerial Council on Energy on 11 December 2003 as part of that process have superseded certain recommendations and findings in the Draft Report.

The Government agrees with Draft Findings 12.1 and 12.5.

By way of correction, the Government notes that the Draft Report, on page 366, states, "The relevant Ministers in all the jurisdictions must agree to all changes" to the Regime. This is not correct. Under section 6(3) of Schedule 1 of the *Gas Pipelines Access (South Australia) Act 1997* certain provisions of the Code may be amended by two-thirds of the relevant Ministers.

Yours sincerely

HON PATRICK CONLON MP
MINISTER FOR ENERGY

22 March 2004