

Our ref: E002118

Mr Tony Hinton  
Presiding Commissioner  
Review of the Gas Access Regime  
Productivity Commission  
LB2, Collins Street East  
MELBOURNE VIC 8003

Dear Mr Hinton

## **INQUIRY INTO THE GAS ACCESS REGIME – WESTERN AUSTRALIAN GOVERNMENT SUBMISSION**

The Western Australian Government welcomes the Productivity Commission Inquiry into the Gas Access Regime and appreciates this opportunity to contribute to the Inquiry process.

It is now several years since the Council of Australian Governments (COAG) endorsed the Natural Gas Pipelines Access Agreement. The agreement in itself highlights the capacity for governments and industry to cooperate effectively in the development of consistent national policy frameworks.

Western Australia is well positioned to realise the broad benefits resulting from an effective Gas Access Regime, including increased economic activity, lower prices for business and household consumers, improved export competitiveness and improved allocation of scarce resources. There are also substantial environmental and social benefits as a result of increased uptake of natural gas.

The time is now right to benefit from experience and to evaluate the impacts of the Gas Access Regime on competitiveness and efficiency in the marketplace. Of significance are the first round of access decisions throughout Australia and the emergence of case law. In addition, the Productivity Commission's review of the national access regime and COAG's energy market review report, "Towards a Truly National and Efficient Energy Market", should provide some useful guidance in these matters.

Western Australia considers that overall the Gas Access Regime is sound, but some improvements are desirable to clarify its interpretation, improve transparency and timeliness of decisions. These changes improve the continuing relevance, efficiency and effectiveness of the Gas Access Regime as market dynamics change.

The following submission sets out issues that Western Australia considers warrant particular attention by the Productivity Commission, in particular that the Inquiry should:

- clearly define the economic principles underpinning the *National Third Party Access Code for Natural Gas Pipeline Systems* (the Code);
- clarify the overarching objectives and pricing principles with respect to the Code and/or the *Gas Pipelines Access Law*;
- independently assess the impact of the Code both on industry and the broader economy;
- assess the application of coverage criteria and whether they require clarification;
- explore the potential for alternatives to direct regulatory intervention, where appropriate, including a framework to facilitate commercial negotiation and light-handed approaches to regulation;
- identify and examine potential improvements to minimise unnecessary delays to the timing of regulatory decisions;
- consider the extent to which the Code promotes efficient greenfields investment and encourages upstream and downstream competition; and
- clarify provisions under the Code in respect to pipeline expansions.

Western Australia would be pleased to expand or clarify further any of the issues set out in this submission and looks forward to the release of the draft report.

Yours sincerely

**ERIC RIPPER MLA  
DEPUTY PREMIER; TREASURER;  
MINISTER FOR ENERGY**

Att.

**INQUIRY INTO THE GAS ACCESS REGIME**  
**GOVERNMENT OF WESTERN AUSTRALIA SUBMISSION – OCTOBER 2003**

**EXECUTIVE SUMMARY**

**INTRODUCTORY COMMENTS**

Western Australia considers overall that the Gas Access Regime is sound, but some fine-tuning is desirable to clarify its interpretation and assess opportunities to improve the efficiency and effectiveness of the regime.

Western Australia wishes to highlight that it is of fundamental importance that an access code be based on sound economic principles.

As illustrated by the recent Epic Supreme Court Case, economic concepts have a rightful place in the determination of revenue and cost assessment for service providers under the *National Third Party Access Code for Natural Gas Pipeline Systems* (the “Code”). As is currently provided for under the Code, the regulator also has the ability to move beyond such theoretical underpinnings as circumstance demands.

**OBJECTIVES**

The Inquiry is urged to clarify the overarching objectives and pricing principles with respect to the Code and the *Gas Pipelines Access Law* (the “Law”).

A clear set of objectives for the Code would provide greater certainty for infrastructure owners, access seekers, investors and other interested parties. It should also help provide clarity for decision makers and enhance transparency, which should improve the timeliness with respect to decision-making.

Cogent, self-contained pricing principles would also assist service providers and regulators to develop robust access arrangements.

The Productivity Commission’s review of the national access regime may provide some guidance in these matters.

In particular, Western Australia would like to see the Inquiry examine the proposed objects clause for Part IIIA in the context of the Law, and assess whether this would provide clarity to the Code.

**BENEFITS AND COSTS OF THE GAS ACCESS REGIME**

Western Australia considers that broad economic, social and environmental benefits can be realised as a result of an effective Gas Access Regime.

However, Western Australia considers there are three major potential costs of access regulation:

- the cost of inappropriate coverage by the Code;
- the cost of regulatory errors; and
- the administrative and compliance costs of the Gas Access Regime.

While it may be difficult to quantify costs associated with inappropriate coverage and regulatory errors, these costs can be minimised by ensuring:

- the coverage criteria are suitable;
- best practice design of the regulatory regime; and
- a strong appeals process is identified.

Benefits may also be difficult to quantify given that there will always be a limited basis for comparison and the ultimate beneficiaries of the Code – consumers - are dispersed, with benefits to them accruing over time.

Nevertheless, both costs and benefits need to be addressed by the Inquiry to evaluate whether the Gas Access Regime provides a net benefit for society.

### **COVERAGE CRITERIA**

Overall, Western Australia considers that the coverage criteria of section 1.9 of the Code are appropriate.

Nevertheless, the Inquiry should examine:

- the interpretation of the coverage criteria under the Code, with a view to eliminating any uncertainties; and
- whether the coverage criteria, and any other aspects of the Code potentially related to policy, would be better placed in the Law rather than in the Code.

### **INFORMATION REQUIREMENTS, LIGHT-HANDED REGULATION AND COMMERCIAL NEGOTIATION**

Given the rationale for regulation and the methodology requirements of the Code as they currently stand it could be argued that information requirements are reasonable.

Alternatively, a light-handed regulatory approach may, in appropriate instances, provide satisfactory outcomes to service providers and customers at little cost, and a basis for successful negotiations. Western Australia suggests that the Inquiry investigate the merits of light-handed regulatory approaches (in association with relevant issues such as coverage and greenfields investment).

Similarly, it is also suggested that the Inquiry assess the extent to which commercial negotiations could be successfully enhanced through amendments to the Gas Access Regime.

### **TIMELINESS OF DECISIONS**

Western Australia encourages investigation of possible improvements to decision-making processes in particular, mechanisms to improve the timeliness of the approval of access arrangements.

### **GREENFIELDS INVESTMENT**

Western Australia supports the introduction of mechanisms that would facilitate efficient investment in greenfields transmission pipelines and distribution networks, and urges the Inquiry to consider incentives in the context of other relevant reviews.

### **ENCOURAGEMENT OF UPSTREAM AND DOWNSTREAM COMPETITION**

Western Australia supports examination of ways of encouraging capacity trading with respect to transmission pipelines and distribution networks where appropriate.

### **OTHER MATTERS**

Western Australia considers that various aspects of the Code regarding pipeline extensions and expansions need to be clarified. These are elaborated upon in this submission.

The Inquiry may also wish to examine whether there have been any concerns from third party users in instances where there is common parent company ownership of gas transporting and selling functions, and whether there is a need to enhance enforcement and compliance verification provisions relating to ring-fencing.

## **INTRODUCTORY COMMENTS**

Western Australia welcomes the Inquiry into the Gas Access Regime. An independent review and analysis of the operation of the Gas Access Regime is timely given experience with the regime to date, completion of first round access decisions, emergence of case law and outcomes of other reviews.

The Gas Access Regime is a positive example of cooperation between governments and industry to develop consistent national frameworks, whilst taking into account important jurisdictional differences.

As a general principle, commercially negotiated outcomes are preferable to direct regulatory intervention. However, this is dependent on the ability for negotiations as far as possible to replicate what would take place in a competitive market between buyers and sellers.

For this to come about there needs to be a degree of balance between the bargaining powers of the service provider and access seekers. Furthermore, in the circumstances of disagreement there must be unrestricted access to arbitration, where all efforts must be expended to ensure that the outcome is fair and reasonable.

If commercial negotiation is not possible or fails, it is necessary for economic regulation to set the terms and conditions of access to those pipelines that meet the coverage criteria. To this end, the regulatory regime should be designed to replicate the outcomes that would occur in a competitive market (including efficient pricing and investment outcomes) and minimise the scope for regulatory errors.

A key feature of National Competition Policy is the establishment of arrangements for access by third parties to services provided by significant infrastructure facilities. Gas access regulation is based on the assumption that where a service provider enjoys a natural monopoly, there is a risk that the owner may seek to extract excess profits flowing from provision of services through the facility to the detriment of society as a whole.

Under usual circumstances the capacity to earn superior profits may attract new entrants to the market, driving down profitability to ordinary levels. To sustain a monopoly position barriers to entry are required. The owner can then exploit the lack of alternatives available to those needing to acquire services provided by the infrastructure by setting prices higher than would be sustainable in a competitive market or by excluding use of the facility by competitors altogether.

Left unchecked by competitive responses or appropriate intervention, the end result of such monopoly pricing behaviour is generally an under-utilisation of the facility's services, accompanied by excess consumer end prices and under-consumption of the final goods and services that rely upon it. There may also be an international dimension to the impacts, such as reduced export competitiveness that diminishes the quantity and value of exports (especially in a price-taking scenario). Unwinding these impacts therefore increases consumer welfare domestically and international competitiveness.

With the lion's share of Australia's gas reserves, Western Australia is well positioned to realise the broad benefits resulting from an effective Gas Access Regime. These benefits can include increased economic activity, lower prices for business and household consumers, improved export competitiveness and improved allocation of scarce resources. There are also substantial environmental and social benefits as a result of increased uptake of natural gas.

As a fundamental principle, access regulation needs to balance a broad range of interests, including consumers and service providers, while simultaneously underpinning investment in infrastructure and reducing the scope for monopoly pricing. In order to achieve these objectives, the Gas Access Regime requires:

- clear objectives and pricing principles;
- a robust economic framework aimed at delivering the correct signals for investment and efficient prices for consumers over the long run;
- appropriate guidance for service providers and regulators to reduce uncertainty and ensure that decisions are consistent with the policy objectives of the Gas Access Regime;
- public consultation, transparency and review of regulatory decisions to provide important checks and balances; and
- a framework to facilitate commercially negotiated outcomes wherever possible.

Western Australia considers overall that the Gas Access Regime is generally sound, but some fine-tuning is desirable to clarify its interpretation and assess opportunities to improve the efficiency and effectiveness of the Gas Access Regime as market dynamics change.

In particular, the Inquiry should aim to:

- clearly define the economic principles underpinning the Code;
- clarify the overarching objectives and pricing principles with respect to the Code and/or the Law;
- independently assess the impact of the Code both on industry and the broader economy;
- assess the application of coverage criteria and whether they require clarification;
- explore the potential for alternatives to direct regulatory intervention, where appropriate, including a framework to facilitate commercial negotiation and light-handed approaches to regulation;
- identify and examine potential improvements to minimise unnecessary delays to the timing of regulatory decisions;
- consider the extent to which the Code promotes efficient greenfields investment and encourages upstream and downstream competition; and
- clarify provisions under the Code in respect to pipeline expansions and extensions.

Western Australia has considered each of these matters and outlines them in more detail below, providing recommendations where appropriate. Some other matters, including ring fencing and forum shopping, are also dealt with at the end of this submission.

## **ECONOMIC THEORY AND THE CODE**

Western Australia wishes to highlight that it is of fundamental importance for any access code to be based on sound economic principles.

Access pricing that is genuinely based on the principles of economic efficiency should encourage competition, use of pipeline infrastructure and encourage investment that is both efficient and effective. This is the case regardless of the actual detailed approach to regulation that is applied (e.g. whether costs and tariffs are calculated based on price path, cost of service or some other approach).

One of the most prominent issues related to economic theory under the Code is the calculation of total revenue and assessment of costs. There are many matters which are directly relevant to and that flow from this issue including:

- the detailed methodology as outlined in the Code;
- matters to be considered by the regulator and the weighting applied to these;
- discretion given to the regulator and perceived uncertainty as to regulated outcomes; and
- impacts on investment.

Certainly, an access code will often have multiple objectives to fulfil and/or a range of matters that must be considered by the regulator. This is the case with the Code, where for example sections 2.24 and 8.1 outline a range of factors the regulator must take into account, and objectives the reference tariff and reference tariff policy should be designed to achieve. However, this does not remove the need for a firm basis upon which to develop the total revenue calculation/cost assessment, and upon which to consider these issues.

Of particular relevance to this issue is the recent Supreme Court of Western Australia decision in *Re Dr Ken Michael AM; ex parte Epic Energy (WA) nominees Pty Ltd & Anor* [2002] WASCA 231 ('*Epic*'). The Supreme Court decision did not rule out the application of economic theory as a basis for determining total revenue. What it did do was to clarify wording/definition and intent of the Code.

For example, one objective under the Code is for the reference tariff and reference tariff policy to be designed with a view to "replicating the outcome of a competitive market". The Court determined that the appropriate benchmark for regulatory purposes was that of 'workable competition' rather than the theoretical concept of perfect contestability.

This decision by the Court has clarified the interpretation of specific economic concepts in the Code, thereby removing some uncertainty associated with the Code's application.

Similarly, the Court also considered the related issues of the setting of the initial capital base and the reasonableness of the price paid by Epic Energy. Epic had requested that the initial capital base be set at a value equal to its purchase price plus acquisition costs, and adjustments for pipeline expansion costs (stage 3A pipeline expansion in 2000), equating to \$2.57 billion.

The Court concluded that in certain cases, and specifically in the case of Epic, that the regulator could depart from the usual range of depreciated actual cost (DAC) and depreciated optimised replacement cost (DORC). Whether there would be any departure in the case of Epic rested on the issue of the reasonableness of the price paid by Epic for the pipeline.<sup>1</sup>

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<sup>1</sup> The Western Australian Gas Access Regulator subsequently determined that Epic's purchase price of the pipeline was not based on a sound commercial assessment of its value.

Thus the Court's decision did not rule out the application of economic theory. In the case of the appropriate competitive benchmark, the Court clarified the meaning and intent of specific terms in the Code. In regard to the setting of the initial capital base, it simply clarified that cases could exist where the value of the initial capital base was outside the normal DAC and DORC range, and that a consideration in this regard was the reasonableness (e.g. based on a sound commercial assessment) of the investment in the pipeline. Thus it clarified what was already in the Code – the initial capital base would usually lie within DAC and DORC, and that the Code allows for circumstances to be considered that could result in values being set outside this range.

This clarification given by the Court is obviously considered very useful to the development and the application of the Code. However, beyond this the Court decision did not diminish the relevance or importance of economic theory as it currently stands in the Code.

Western Australia considers that economic concepts have a rightful place in the determination of revenue requirements and cost assessment for service providers under the Code, together with the ability of the regulator to move beyond such theoretical underpinnings as circumstance demands, as is currently provided for under the Code.

## **OBJECTIVES**

There is no overarching, definitive objective of the Code and Law, and the pricing principles are dispersed, overlap and may cause ambiguity.

A clear set of objectives would provide greater certainty for infrastructure owners, access seekers, investors and other interested parties, and provide clarity for decision makers, and enhance transparency and timeliness with respect to decision making.

Western Australia agrees in principle with the Commonwealth Government's interim response to the review of the national access regime, regarding incorporation of a clear objects clause under Part IIIA of the *Trade Practices Act (TPA)*. In addition, the recommendation that decision makers should be required to have regard to the objectives specified in the objects clause is supported in principle by Western Australia.

Western Australia would also like to see the Inquiry examine the proposed objects clause for Part IIIA in the context of the Law<sup>2</sup> and whether this would provide clarity to the Code.

In addition, cogent, self-contained pricing principles would assist service providers and regulators to develop robust access arrangements. If these principles are established correctly there should be no reason for decisions to favour the interests of one party over another.

The Inquiry is encouraged to examine the pricing principles of the Code in light of the body of experience to date, with a view to providing greater clarity and minimising the scope for contention.

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<sup>2</sup> The Council of Australian Governments, *Towards a Truly National and Efficient Energy Market: Energy Market Review Final Report*, December 2002, p.94. In line with recommendations for governance and regulatory arrangements, the report raised that policy provisions embedded in the Code could be transferred to the Law.

Western Australia supports the Commonwealth's interim response to the Productivity Commission's recommendation to include broad pricing principles under Part IIIA. The broad principles identified should provide a firm basis for examination of more specific pricing principles in respect to the Gas Access Regime.

Western Australia has provided a detailed response to the Commonwealth Government regarding its interim response to the review of the national access regime, and can provide further details to the Productivity Commission in these matters if considered useful.

### **BENEFITS AND COSTS OF THE EXISTING GAS ACCESS REGIME**

A thorough independent analysis of the costs and benefits of the Gas Access Regime is a necessary aspect of identifying potential improvements to the Code.

The benefits of an effective Gas Access Regime can include increased economic activity, lower prices for business and household consumers, improved export competitiveness and improved allocation of scarce resources. There are also substantial environmental and social benefits as a result of increased uptake of natural gas.

However, it is considered that there are three major potential costs of access regulation:

- the cost of inappropriate coverage by the Code;
- the cost of regulatory errors; and
- the administrative and compliance costs of the Gas Access Regime.

The first two costs may be difficult to quantify. However, in respect to administrative and compliance costs, Table 1 shows the costs of the Office of Gas Access Regulation (OffGAR) from 1999/00 to 2002/03 (expressed in terms of cents per GJ of throughput of regulated pipelines)<sup>3</sup>. The table shows that the regulator's costs have been less than 1 cent per GJ over the period. However, it is important to note that this information does not include the costs separately incurred by service providers and other parties.

Table 1: Regulatory Costs: OffGAR (cents per GJ)

Year	1999/00	2000/01	2001/02	2002/03
Cost (cents/GJ)	0.66	0.64	0.55	0.70*

\* The substantial increase in 2002/03 is largely attributable to legal action related to the Dampier to Bunbury and Goldfields Gas Pipelines.

While it may be difficult to quantify the costs associated with inappropriate coverage and regulatory errors, the Western Australian Government would welcome an independent assessment of these costs. However, it should be recognised that these costs can be minimised by:

- ensuring the coverage criteria are suitable (discussed below); and
- best practice design of the regulatory regime and a strong appeals process.

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<sup>3</sup> Estimates provided by the Office of Gas Access Regulation.

Hence, any improvements identified as part of the broader Inquiry process could have a significant impact on these costs in the future.

Benefits may also be difficult to quantify given that there will always be a limited basis for comparison and the ultimate beneficiaries of the Code – consumers - are dispersed and tend to receive benefits over time.

Nevertheless, both costs and benefits need to be addressed by the Inquiry to evaluate whether the Gas Access Regime provides a net benefit for society.

### **COVERAGE CRITERIA**

Clear and appropriate coverage criteria would provide certainty for all relevant parties and simplify the development of regulation of covered pipelines.

Given that regulation involves costs, it is highly desirable to limit its application to those cases where it is necessary. Regulating a pipeline when there is no material justification will produce net costs for society, most simply through the costs of the regulatory process but more importantly through the potential for introducing market distortions and adverse impacts on investment decisions.

Conversely, if a pipeline is not regulated when regulation should be applied, it will create costs in terms of production, consumption and investment inefficiencies. It is therefore vitally important that appropriate coverage criteria is developed and applied.

Overall, Western Australia considers that the coverage criteria of section 1.9 of the Code are appropriate. However, the practical application of the Code has identified some uncertainties associated with definitions and interpretation of the criteria.

Given the ultimate aim of providing third party access, the criteria rightly identify the promotion of competition [section 1.9 a)] and the costs of developing a duplicate pipeline [section 1.9(b)] as key considerations. It is fundamental that provision of third party access should maintain human health and safety hence section 1.9(c) is appropriate. Finally, the Western Australian Government strongly agrees with section 1.9(d) of the Code, which states "*that access (or increased access) to the Services provided by means of the Pipeline would not be contrary to the public interest*". It is important that the public interest is considered when a decision on coverage is being made.

However, the experience gained since the introduction of the Code may highlight certain factors that should be given weight in the consideration. The public interest is a broad concept intended to allow full account to be taken of social, environmental, regional and economic impacts. One aspect of this consideration should be the costs of regulation. In particular, this includes the costs to the service provider of complying with the Code such as drafting an access arrangement and going through the Code process to finalise that access arrangement, and similarly the costs to the regulator of administering this process and approving an access arrangement.

As has become apparent since the Code was introduced, the process of approving an access arrangement is often a lengthy one. To a certain extent this is to be expected in dealing with significant pieces of infrastructure, with important linkages to upstream and downstream markets. Nonetheless, it is pertinent that the costs of the regulatory process are taken into account.

The key issue from the above, as is the intent of National Competition Policy and the process for the provision of third party access, is that coverage should only be extended to those pipelines where such coverage would result in an overall net benefit to the public.

Related to this matter, the Issues Paper asks the question to what extent has the option to revoke coverage been utilised, and are any improvements required. Being satisfied with section 1.9 of the Code, Western Australia is also satisfied with the Code in regard to revocation of coverage, and the manner in which the National Competition Council (NCC) has applied these provisions. Over the last few years, the NCC has been called upon to consider revocation requests from a number of pipeline owners. For pipelines located in Western Australia, administration of the revocation process has been conducted in an open and efficient manner.<sup>4</sup>

Western Australia recommends that the Inquiry examine the interpretation of the coverage criteria under the Code, with a view to eliminating any uncertainties given the body of experience. It is also suggested that, in order to facilitate clarity and certainty, the Inquiry investigate whether the coverage criteria (as a matter related to policy as opposed to regulation) would be better placed in the Law rather than in the Code.<sup>5</sup>

#### **INFORMATION REQUIREMENTS, LIGHT- HANDED REGULATION AND COMMERCIAL NEGOTIATION**

The Code and the access arrangement approval process contained within it, including factors and methodologies to be considered, naturally imply that a significant amount of information is required by the regulator in the course of approving a proposed access arrangement. Although there will be some variance in the resources required by the regulator to assess the information presented by different service providers<sup>6</sup>, the process and requirements outlined in the Code do imply a base set of information is required.

When considering the issue of information requirements and whether these are too onerous on service providers, it needs to be kept in mind why regulation is being applied. Key reasons for regulation include the infrastructure being significant, duplication being uneconomic, and competition being enhanced through the provision of regulation/third party access.

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<sup>4</sup> For pipelines located in Western Australia, there have been five applications to revoke coverage:

- in July 1999, an application for revocation of four laterals off the Goldfields Gas Pipeline resulted in revocation of three of the four laterals;
- in July 1999, an application for revocation of the Tubridgi and Beharra Springs gas pipelines resulted in successful revocation of the Beharra Springs pipeline, but not the Tubridgi pipeline;
- in September 1999, coverage of the Karratha to Cape Lambert pipeline was revoked;
- in October 2001, coverage of the Parmelia Pipeline was revoked; and
- in March 2003, an application for revocation of the Goldfields Gas Pipeline was submitted to the National Competition Council. The Council delivered its draft decision on 8 September 2003 not to revoke coverage.

<sup>5</sup> See footnote 2.

<sup>6</sup> It would be reasonable that the level of resources applied by a regulator would be greater for those service providers operating more significant infrastructure, as there would be greater costs associated with setting inefficient tariffs and these would be more likely to have an impact on users and the economy in general. For example, we would expect to see a difference in the level of resources applied by a regulator between a gas network operator whose regulatory capital base is \$1,000m compared to one whose value is \$20m.

Given the reasons for regulation and the methodology/requirements of the Code as they currently stand, it could be argued that the information requirements are reasonable. The regulator requires a certain set of information in order to regulate the service provider under the Code.

At the same time, it is probably fair to say that the regulated gas pipeline service providers believe that the current application of regulation is onerous and heavy handed. Indeed, light-handed regulatory approaches may in appropriate instances, provide satisfactory outcomes to service providers and customers at little cost, and a basis for successful negotiations.<sup>7</sup>

While service providers may argue that the application of regulation is heavy handed and onerous, it needs to be remembered that there is a social dimension to regulation. The regulator needs to consider whether the outcomes of the regulatory approach would provide a net public benefit and meet the objectives of the Code.

Related to the issue of light-handed regulation, there was an expectation with the introduction of National Competition Policy and third party access that the Gas Access Regime would be one akin to a 'negotiate and arbitrate' model. Regulatory costs would be minimised where service providers and users are able to satisfactorily negotiate commercial outcomes without regulatory price setting. However, in practice, a reliance on the Code's access arrangement approval process appears to have developed.

A factor influencing this outcome may be a relative imbalance in strength of the parties involved (i.e. an owner of a significant monopoly infrastructure as opposed to users accessing, or those wanting access to that infrastructure). This may be of particular relevance to distribution systems. There are also likely to be other factors at play which could be investigated. Despite commercial negotiation being an option under the Code there may be minimal incentives for users to follow this route.

Western Australia suggests that the Inquiry investigate the merits or otherwise of light-handed regulatory approaches (in association with relevant issues such as coverage and greenfields investment). It is also suggested that an assessment is made as to the extent to which commercial negotiations could be successfully enhanced through amendments to the Gas Access Regime.

Moreover, some of the potential refinements to the Code/regulatory framework as discussed by the Productivity Commission in its review of the national access regime (e.g. access holidays) would lead to reduced information requirements.

#### **TIMELINESS OF DECISIONS**

While recognising that the time taken to approve access arrangements under the Code has been lengthy, adequate processes are necessary to ensure proper consultation, evaluation and procedural fairness, which is critical for durable and appropriate outcomes.

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<sup>7</sup> The definition of 'light-handed' regulation may in part reflect the subjective assessment of individual parties. However, it would be fair to say that price monitoring is a form of light-handed regulation, as could be other approaches that require less information and regulatory intervention compared to the current requirements of the Gas Access Regime.

Having said this, Western Australia considers that timeliness could be improved without exposing the regulator to the threat of review and the imposition of further delays. For instance, in some cases the lack of timely information provision by service providers has extended regulatory timeframes. One possible means to address this is to consider what elements of an access arrangement could be considered in advance of the normal review period.

Western Australia encourages investigation of possible improvements to decision-making processes, in particular the approval of access arrangements. Improvements should be considered in the context of clarification and amendment to provisions of the Code.

## **GREENFIELDS INVESTMENT**

Western Australia supports the introduction of mechanisms that would facilitate efficient investment in greenfields transmission pipelines and distribution networks, and at the same time form part of an appropriate regulatory framework.

The Code may be more attuned to facilitating access and investment in relation to existing brownfields pipelines rather than facilitating construction of new greenfields pipelines, and could be improved to provide greater incentives in regard to the latter.

The Inquiry provides for timely consideration of those recommendations from the review of the national access regime and COAG's review of energy market directions that are relevant to the facilitation of greenfields investment for both transmission and distribution pipelines.

For instance, the Inquiry may wish to consider the national access regime review recommendation that proponents of proposed investments in an essential infrastructure facility be able to seek a binding ruling on whether the services provided by that facility would meet the declaration criteria, in the context of experience under the Gas Access Regime.

The provision of binding rulings has the potential to encourage new investment as it will provide greater certainty to the service provider and remove some risk. Another benefit is that it would clearly reduce the costs associated with regulation. However, the extent to which these benefits are realised will depend on the detailed process surrounding the operation of binding rulings.<sup>8</sup>

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<sup>8</sup> For example, under what circumstances would the NCC reconsider a binding ruling, and related to this, would users of the pipeline and other industry stakeholders be able to request that the NCC reconsider the binding ruling?

If so, then at first glance there may appear to be little difference compared to the current process for coverage and revocation of coverage under the Code. That is, at a point in time the NCC may determine, and the Minister may accept, that a particular gas infrastructure asset not be covered under the Code. However, if circumstances change, a user (or potential user) may apply to the NCC that the asset be a covered pipeline. The question then, is how the binding ruling process would be different if the decision can be revoked when there are material changes in circumstances?

For binding rulings to result in additional benefits such as those discussed above, the decision process would have to be in some way different to the process for coverage.

In addition, the Productivity Commission recommended that the Commonwealth, through COAG, should initiate a process to refine mechanisms to facilitate efficient investment within the Part IIIA regime in particular, and access regimes in general. This should include mechanisms such as:

- fixed term access holidays available to any proposed investment in essential infrastructure which is determined to be contestable; and
- provision for a 'truncation' premium to be added to the cost of capital, agreed between a project proponent and the regulator prior to the investment.

Western Australia sees merit in the concept of fixed term access holidays for investments that are contestable (i.e. investments made on the basis of a competitive tendering process). Such an approach has appeal in regard to the prospect for monopoly rents being dissipated through the contestable process, and removing the need for costly regulation during the access holiday period. However, it is noted that following this period it is possible that the infrastructure could become covered, and therefore be subject to the more detailed regulatory process as may be outlined in the Code at that time.

Moreover, there may be special circumstances including significant regional and intra-regional differences, which may need to be borne in mind in the treatment of greenfields pipelines. For instance, inter-fuel competition may constrain monopoly rents and mechanisms such as access holidays could, for example, facilitate efficient medium to long-term outcomes.

Further consideration is required on the provision of a 'truncation' premium and other mechanisms that may be effective in promoting efficient investment and refining the regulatory framework. Western Australia supports detailed consideration of these matters as part of this Inquiry.

While Western Australia is mindful of the need to reduce complexity of the Code as far as possible, the Inquiry may also wish to investigate whether other aspects of the Code could be treated separately for greenfields pipelines.

#### **ENCOURAGEMENT OF UPSTREAM AND DOWNSTREAM COMPETITION**

The Inquiry has raised the issue of capacity trading for contract carriage pipelines as a means of promoting competition in related markets.

Capacity trading may provide benefits through more efficient use of pipeline capacity, efficient investment decisions, and increased competition. However the concept needs to be carefully considered. Importantly, it would be contrary to national competition policy principles for monopoly power to be transferred from pipeline owners to users. In addition, it is noted that the extent to which capacity trading promotes competition would also depend in part on the market structure in upstream and downstream markets.

In examining this issue, there may be a need to distinguish between transmission pipelines and distribution networks. For instance, contracted pipeline capacity may not be as relevant for distribution networks, except for high pressure laterals that may be present in some distribution networks, although this should be adequately investigated.

It also appears that gas full retail contestability has been introduced in several jurisdictions and generally there do not appear to be significant issues in relation to access to distribution networks and the transfer of customers and consequently 'delivery capacity'. Nevertheless, the Inquiry should examine whether any significant issues have arisen.

In respect to transmission pipelines, there may be a need to further emphasise that users and their utilisation of capacity have a role in the efficient utilisation of the pipeline. This may require the enhancement of relevant provisions of the Code; for instance, section 5.8 relating to information provided by users to the market in respect to contracted capacity usage, and section 5.9 relating to potential requirements on the pipeline operator to maintain a public register of spare and developable capacity.

The Inquiry is also encouraged to examine whether incentives for the development of a secondary market for capacity are required. If such a requirement were found to exist, it should be explored as to whether the Capacity Management Policy (section 3.7) is the appropriate mechanism to provide for such development of a secondary market.

## **OTHER MATTERS**

### *EXPANSIONS AND EXTENSIONS OF COVERED PIPELINES*

Timely and economic expansions and extensions of covered pipelines are as important to the economy as investment in new pipelines.

However, there appear to be a number of potentially incongruent provisions under the Code in respect to expansions/extensions, and potential for multiple decision makers and processes in relation to coverage of pipelines (refer to sections 3.16, 6.15, 6.18 and 6.22 of the Code). This adds to uncertainties in the operation of the Code.

For example, under the expansions/extensions policy in an access arrangement (section 3.16) it is possible that the expansion may not be covered by the Code. Also, under the Code, the Arbitrator has the ability to require an expansion of the capacity of the covered pipeline (section 6.22), and to deal with the costs of the expansion, including "the cost of extending the pipeline" (section 6.15). There appears to be an inconsistency here in that:

- the Arbitrator could require that an expansion/extension take place; but
- that expansion/extension may not be covered under the Code; and therefore
- the arbitration provisions do not apply to that expansion/extension.

The Inquiry may then wish to examine how the Code could be improved to provide clarification in this matter.

Automatic coverage of expansions/extensions may be one way of addressing this issue.<sup>9</sup> In considering this option, the Inquiry needs to consider potential concerns that industry may have, and whether Code provisions addressing the efficiency of expansions/extensions and the appropriate recovery of related costs (see sections 8.15-8.29) are sufficient to address potential concerns by industry. Among these provisions are:

- criteria to be used by the regulator in considering future investments and the rolling-in of investments related to expansions and extensions;
- how a service provider may obtain some certainty in regard to recovering costs of future investment;
- capital contributions; and
- imposition of surcharges.

The issue of pipeline expansions/extensions is particularly important for Western Australia as highlighted by the current situation involving Epic Energy and its ownership of the Dampier to Bunbury Natural Gas Pipeline (DBNGP). In particular, there is a concern that financial difficulties experienced by the owner are preventing the timely expansion of the DBNGP. As the DBNGP cannot take on any new major loads, failure to expand the pipeline has a range of potential implications for this State.

Whether there are current processes, or could be processes, for alleviating such problems is therefore an important issue for Western Australia. Current aspects of the Code and any proposed amendments that encourage investment and give a greater degree of certainty to the service provider can go some way to alleviating the type of problem highlighted above. In this regard, it is noted that the current and usual process for pipeline expansions/extensions under the Code is one reliant on the service provider proposing an investment, which the regulator would then assess.

The particular issue for Western Australia is what avenues are available where the service provider is not proposing expansions/extensions. It is noted that the dispute resolution procedures under section 6 of the Code may have some scope to deal with such issues. For example, under certain circumstances the pipeline owner can be required to expand capacity. Nevertheless, these processes can be protracted and give rise to significant constraints on economic development or at least uncertainties which can lead to second order outcomes.

Although the factors surrounding Epic Energy and its ownership of the DBNGP are likely to be unique, it nonetheless raises important issues in regard to incentives and processes for expansions/ extensions of pipelines. Western Australia encourages examination of such issues as part of this Inquiry.

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<sup>9</sup> The Inquiry is also referred to the ACCC decision on the Moomba to Adelaide Pipeline System and the DBNGP in respect of expansions/extensions and their coverage.

*RING FENCING*

The Code appears to have adequate requirements in respect to ring fencing. However, the Inquiry may wish to examine whether there have been any concerns from third party users in instances where there is common parent company ownership of gas transporting and selling functions, and whether there is a need to enhance enforcement and compliance verification associated with this requirement.

*FORUM SHOPPING*

In its review of the national access regime, the Productivity Commission recommended that the Code be amended to provide that where a pipeline owner potentially covered by the Code lodges a Part IIIA undertaking, this would trigger an assessment by the NCC to determine whether the pipeline meets the requirements for coverage under the Code.

Western Australia supports this recommendation. Importantly, such a process would remove the ability to forum shop, would support the use of effective certified regimes and would assist in providing greater consistency in the application of regulation to gas pipelines.