



Australian Energy Markets Commission

**Review into the scope of economic regulation
applied to covered pipelines**

GPR0004

Draft Report

Submission by

The Major Energy Users Inc

March 2018

Assistance in preparing this submission by the Major Energy Users Inc (MEU) was provided by Headberry Partners Pty Ltd.

This project was part funded by Energy Consumers Australia (www.energyconsumersaustralia.com.au) as part of its grants process for consumer advocacy and research projects for the benefit of consumers of electricity and natural gas.

The views expressed in this document do not necessarily reflect the views of Energy Consumers Australia. The content and conclusions reached in this submission are entirely the work of the MEU and its consultants.

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1. Introduction

The Major Energy Users Inc (MEU) welcomes the opportunity to provide its views on the AEMC draft report into its review of economic regulation applied to covered pipelines.

The MEU notes that in its response to the issues paper released by the AEMC in 2017 there were a number of key aspects that the MEU considered were desirable changes to the regulatory approach to gas pipelines. The MEU had highlighted that the promising outcomes from the well thought out energy reforms, begun in the 1990s to enhance Australia's economic development, have been sadly overturned by the loss of our international competitiveness in electricity and, more recently, gas pricing. This, in part, is a result of the inadequate regulatory framework that has applied to monopoly gas and electricity transport services.

In addition to the concerns the MEU has with regard to gas pipeline regulation and the rules that apply to it, the MEU highlights the decisions to remove many gas pipelines from even the flawed regulatory oversight that applied on the spurious grounds that these pipelines were subject to competition. This removal of regulatory oversight allowed pipeline owners to exercise considerable market power and impose considerably higher prices for the gas transport services offered and apply unreasonable conditions for their use. This aspect of the gas pipeline industry was the prime cause for the ACCC to recommend changes to the approach to gain regulatory coverage of gas pipelines in its enquiry into the east coast gas market. The ACCC and AEMC recommendations to their east coast gas enquiries ultimately resulted in changes to the rules applying to pipelines not covered by regulation (now called non-scheme pipelines). In some ways, these changes have resulted in some aspects of the rules applying to non-scheme pipelines being more stringent than those applying to regulated pipelines.

This change in dynamic has led to a need to introduce greater consistency in gas pipeline regulation for both regulated and non-scheme pipelines. The MEU is pleased to note that the draft report addresses many of these inconsistencies and recommends a number of well developed changes.

The MEU also notes that the changes proposed by the AEMC in its draft report have failed to address the very fundamental issue that the transportation of gas is controlled by a very few service providers and that gas transportation industry is highly concentrated. As with any industry which reflects such a high degree of concentration, this provides an opportunity to maximise the rewards for pipeline owners to the detriment of consumers and limits the benefits to consumers that come from vigorous competition.

The MEU also raises an important issue that underpins much of the much of the AEMC logic – that greater access to information provision and input changes to balance the market power of the pipeline service providers that a well informed

consumer base will deliver, assumes that end users have sufficient resources to enter into meaningful negotiations and to provide valuable input to regulatory decisions. In practice, this assumption is flawed on two counts

Firstly, for a meaningful negotiation to take place with a monopoly service provider requires the end user to see that the reward it will get will exceed the costs it incurs in being involved in negotiations and even subsequent arbitration. This point is discussed in more detail below.

Secondly, the funding available to consumer advocates to join in the regulatory processes is quite limited. This is demonstrated by the very few informed submissions received by regulators as part of a reset process¹. The MEU points out that regulators have consistently highlighted that submissions to their processes need to be comprehensive and address issues that impact the regulatory decisions².

In the absence of sufficient funding of advocates on behalf of consumers, for the AEMC to assume that by addressing apparent imbalances in information flow this will result in better outcomes in the long term interests of consumers (as is required by the National Gas Objective – NGO) overlooks the essential fact that without adequate funding to enable the use of the new tools, these changes will have less of an impact than is assumed by the AEMC

2. The MEU response to the Issues Paper

In its response to the Issues paper, the MEU highlighted concerns about a number of aspects of the gas market and the associated transportation of gas. These aspects included

-) While gas might be delivered to a point of consumption by more than one pipeline, these so-called competing gas pipelines are delivering gas from different gas production sources. Despite this obvious difference, regulation which imposed a surrogate for competition was removed allowing pipeline owners free rein on the pricing for the services they provided. The advent of the new Part 23 to the gas rules has provided some benefit to consumers, but imposes significant costs on consumers to achieve an equitable outcome.
-) The threat of coverage has proved to be a “toothless” tiger. The rules for removing a pipeline from being regulated are significantly different from those which would impose regulation, so much so that even where it is

¹ Even a cursory review of the submissions to the regulatory processes attests to the fact that there are few submissions from consumers in the regulatory process and that many, if not most, of them do not address in much detail the issues that regulators need consumers to provide advice on.

² The regulators have consistently advised that submissions stating that prices are too high or costs are unaffordable but without arguments explaining how these issues can be addressed within the context of a regulatory decision, are simply not useful at all

clear that a pipeline provides monopoly services, to get the pipeline subject to regulation has been shown to be virtually impossible.

-) Where a pipeline need not be regulated due to all of its capacity being managed under a long term contract (whether due to being addressed under a “greenfield” approach or otherwise) when that contract expires, this should not result in the pipeline no longer being regulated and it should revert to being covered as a regulated pipeline.
-) There is a concern about the application of a price cap approach to regulating a pipeline as this allows the pipeline owner to sell other services on the same pipeline where the reference service effectively covers the full cost of the pipeline operation. The sale of these other services allows the pipeline owner to recover more revenue that was assessed by the regulator as being an efficient revenue stream.
-) The application of contract carriage for a pipeline provides an avenue for the pipeline owner to sell other services and for permitting hoarding of capacity.
-) Augmentation of pipelines is not prevented by market carriage or regulation, despite assertions to the contrary. In fact, it is the underwriting of an investment by a prospective user (either by a regulator allowing the costs to be socialised or by a shipper committing to pay for the increased capacity) that results in augmentations and extensions. The very lack of speculative investment that has occurred over the past 20 years of gas pipeline regulation attests to this fact, even though speculative investment is envisaged under the regulatory process and that perhaps private ownership coupled to contract carriage is not as efficient in initiating investment as is assumed and asserted.
-) Arbitration is a barrier to involvement, especially for smaller consumers, and there are less costly alternatives that could be considered.

The MEU concluded that a significant cause of the issues identified by its members lie with the gas market rules for regulated (and unregulated) gas pipelines not being sufficient to meet the needs of consumers. It is with these thoughts in mind the MEU provides the following comments on the draft report provided by the AEMC.

3. The GMRG process

While involved in the current Gas Market Reform Group (GMRG) processes, the MEU was particularly involved in the GMRG process to implement the changes that led to the development of Part 23 of the gas rules. While the MEU has pointed out to the GMRG that there are limitations in the approach using commercial arbitration as a tool for limiting the exercise of market power by non-scheme pipelines, the MEU does recognise that Part 23 of the rules has resulted in a significant improvement to what applied before its introduction.

In particular, the MEU considers that

-) The approach established for guiding the arbitrator to assessing prices for services provided, potentially delivers a better outcome for consumers than perhaps the approach applied for covered pipelines.
-) The requirement for provision of information is the equal (if not better) than for fully covered pipelines and certainly better than for lightly regulated pipelines

The MEU still has reservations about the Part 23 rules in that there is still an ability, despite the fact that the pipeline still has a monopoly position for the services it provides, for the pipeline owner to recover more revenue than is needed to cover its reasonable costs. This over-recovery is permitted through the uncontrolled sale of different services and the barrier imposed on consumers by the cost of arbitration.

So while the processes outlined in Part 23 of the rules for non-scheme pipelines is better than what applied before the introduction of Part 23, from a consumer's viewpoint, there could be further improvements, especially noting that the cost of arbitration is a barrier to end users seeking to counter the exercise of market power.

4. The tests for determining which type of regulation applies

The MEU notes there are now at least five types of regulation that may be applied to gas pipelines

1. Full regulation
2. Light regulation
3. Part 23 regulation
4. 15 year exemption
5. No regulation

The MEU, the ACCC and the AEMC have both identified that the coverage criteria for gas pipelines in the National Gas Law are essentially unworkable, and act to prevent coverage of a pipeline that should sensibly be subject to regulation due to its monopoly characteristics. While the change to add Part 23 to the rules has alleviated to some extent the difficulty in getting a pipeline covered that should be covered, there is still a residual issue. The MEU notes that the AEMC has taken considerable effort to address the residual concern in section 3.4 of the draft report

In its recommendation 3 in its report to the CoAG Energy Council "Inquiry into the east coast gas market April 2016" page 11, the ACCC stated

"The COAG Energy Council should agree to replace the current test for the regulation of gas pipelines (the coverage criteria) in the NGL with a new test.

This test would be triggered if the relevant Minister, having regard to the National Competition Council's recommendation, is satisfied that:

- the pipeline in question has substantial market power
- it is likely that the pipeline will continue to have substantial market power in the medium term
- coverage will or is likely to contribute to the achievement of the NGO.

The COAG Energy Council should also ask the AEMC to carry out further consultation on the specific matters that should be considered when applying this test and how it should be implemented and to advise the COAG Energy Council of the amendments that would need to be made to the NGL and the NGR to give effect to this new test."

In its review of the east coast gas market the AEMC and its consultants also identified that the coverage criteria were difficult to fulfil. The MEU recognises that the review by Dr Vertigan did not address a need for a change to the coverage criteria and concentrated on developing a mechanism to better control the market power of pipelines that were not regulated.

While the Part 23 changes impose some degree of regulation on non-scheme pipelines, the MEU is concerned that in its draft report the AEMC has not recommended that the coverage criteria be changed from the current and effectively unworkable criteria to something which is workable and more along the lines that the ACCC and the AEMC and its consultants recommended.

To maintain the current criteria does not assist in any way to provide an outcome that is in the long term interests of consumers as required by the NGO, but as the AEMC observes, retaining the current wording in the coverage test could lead to significant under-regulation which would deliver an outcome that does not meet the NGO. The MEU is very concerned that by not changing the coverage criteria (especially criterion (a)), monopoly pipeline service providers will still be able to exercise significant market power

While the AEMC provides considerable discussion on the issue of the coverage criteria and even proposes an option to the current arrangements, what is overlooked in the AEMC analysis is that seeking coverage and/or seeking arbitration under Part 23 both impose considerable costs on those consumers seeking to get a satisfactory outcome – essentially these costs impose a barrier to involvement and limit the ability of most consumers (especially small consumers) to be able to use the new tools provided in the AEMC draft report or through using Part 23..

A consumer will only seek to engage in the processes if it considers that the reward will deliver an outcome that exceeds the costs that will be involved in obtaining that reward. One MEU member has advised that it incurred costs measured in a six figure sum in its bid to have regulated what was a clearly a

pipeline providing monopoly services, so the MEU can see that few end users of gas pipelines will assess that the reward from seeking regulation will adequately offset the risk and cost of entering into the process³.

This same issue will apply to an end user seeking arbitration under Part 23, so the MEU is very concerned that the cost of seeking coverage and when this is unsuccessful, having to seek arbitration, will provide such a barrier to end users that the monopoly service provider will be able to continue its monopoly practices. Based on the experiences of its members, the MEU can see that if a service provider decides to contest an arbitration process vigorously, costs measured in six figure sums will be incurred by end users seeking to constrain a service provider's market power.

In its analysis of the options to address the coverage criteria, the AEMC has failed to assess that the costs to end users involved in getting change are significant. The MEU also reiterates the point that when retailer/shippers gain little benefit in using their resources to assist an end user, they will not provide support if that benefit will also be available to their retailer competitors⁴.

The MEU considers that even the option proposed by the AEMC to address the coverage issue fails to address the costs that an end user might incur as a result of having to achieve an appropriate outcome and whether these costs impose a barrier to other (smaller) end users. The MEU notes that the AEMC expresses considerable concern about the costs of regulation imposed on service providers and the impact these have on an efficient outcome, what is not considered are the costs that consumers might incur if they do not have the efficient outcome that is the focus of the NGO.

The MEU does not consider that the analysis by the AEMC regarding the coverage criteria has fully addressed all of the core issues, especially the barrier that costs incurred by end users will cause to achieving efficient outcomes. The MEU considers the AEMC report needs to recommend changes to the coverage criteria along the lines initially recommended by it and the ACCC.

This issue is further complicated by the recognition by the AEMC that there will need to be greater flexibility in moving from one type of regulation to another as circumstances change. The AEMC quite rightly identifies that the energy markets are changing much faster than they have in the past and that what was appropriate (say) 2 years ago might not be appropriate now or in 2 years time.

³ MEU members are already involved with "negotiations" with gas transport service providers as a result of the introduction of Part 23 and advise that the costs involved are significant.

⁴ This is the experience of a number of MEU members who advise that when seeking better energy transport outcomes get little or no assistance from their retailers when the retailers see that any benefit achieved will be available to their competitors. The MEU points out that this is also a reason why retailers have little involvement in the regulatory processes regarding networks.

This means that there is a need to introduce a process that allows easier movement from one type of regulation to another as circumstances change over time. What the MEU considers is needed is a process that enables changes between no regulation, 15 year exemption, regulated, light and non-scheme regulation to be smooth (and back again); a process which is more readily implemented than applies now is essential. The current processes to change the type of regulation is “clunky” and methods to move between different types (and even back) should be proposed as an integral element of the report.

For example, the application of the coverage test (proposed by the AEMC to remain unchanged) effectively prevents any non-scheme pipeline from becoming regulated⁵ even if regulation is seen to be appropriate when considering the realities of its role in delivering gas from one point to another. The AEMC asserts that a reversion to the changes proposed in the Harper review to the wording of the legislation providing third party access under the Competition and Consumer Act (CCA)⁶ will provide “a lower bar” to prove a need to regulate a gas pipeline. The MEU disagrees. An essential element of the coverage test in both the CCA and the Gas Law is that upstream or downstream competition must be increased as a result of regulation.

It is possible that the application of a with/without test can be applied in the case of a commercial enterprise using a pipeline to deliver gas to its operations, as an assessment of market power will provide a view as to whether a pipeline exhibits market power characteristics (the test proposed by the ACCC). Under the current criterion (a) and applying a with/without test because a business user *might*⁷ be able to demonstrate that increased competition in a downstream market will result, this is not the case where the gas is used by those who use gas but do not operate in a market as such.

For example, in its application for coverage of the South Eastern Pipeline System (SEPS), Kimberly-Clark Australia (KCA) found it challenging (to say the least) that proving there would be increased competition in its downstream market as a result of coverage, especially where there is already some level of competition⁸. The test also does not differentiate between locally made and imported goods, but the impact could well be major as a local production facility is an employer, and the closure of such a facility would result in the loss of such employment. But this aspect is not assessed in a market competition analysis.

KCA and others also pointed out that, as well transporting gas directly to the KCA production facility, the SEPS also provided gas transportation services to many residential consumers of gas in the Mount Gambier region, yet these residential consumers of gas could never prove that criterion (a) could be

⁵ Unless the service provider seeks coverage

⁶ ie the with/without test

⁷ The MEU uses the term “might” advisedly, because even where an end user operates in a downstream market, it is still difficult to prove that there will be increased competition.

⁸ Decreased competition in the downstream market if coverage is not applied is much easier to demonstrate.

satisfied because they do not operate in a competitive market and so were unable to demonstrate that increased downstream competition would result from coverage, leaving residential consumers at the mercy of the monopoly service provider. The MEU points out that even though SEPS now might be subject to Part 23 rules, the cost of an arbitration process would be prohibitive when compared the benefit a residential consumer (or even a group of residential consumers) would gain from an arbitration process⁹.

In counterpoint, the test for moving from a fully regulated pipeline to a non-scheme pipeline or lightly regulated pipeline is easy, requiring only for the pipeline owner to show that the cost of regulation is significant and that regulation would not deliver benefits to consumers that exceed the cost of regulation. So the test to remove regulation has a much lower hurdle to meet whereas to achieve regulation has a much higher hurdle – there is significant asymmetry between achieving the two outcomes to the disadvantage of consumers.

A similar result applies for movement between light regulation and full regulation, again to the disadvantage of consumers.

The MEU is not convinced that the AEMC has fully appreciated the asymmetry between gaining and revoking coverage, or the practical difficulties faced by those seeking coverage.

The MEU is also not convinced that there now remains sufficient reason to retain “light regulation”. The reason for having light regulation is that the costs of full regulation are supposedly high and that the benefits to consumers of having full regulation are less than these costs. However, the introduction of increased reporting (both for information and the additional elements now added to pricing aspects) means that the cost of light regulation is much higher than in the past. When it is also considered that the introduction of the binding guideline on rate of return will reduce regulatory costs considerably¹⁰, the cost differential between light and full regulation will be small.

Specifically, when assessing the increased obligations to be imposed on “lightly regulatory pipelines” the MEU considers there is no reason to maintain “light regulation” on the three distribution networks that are currently subject to this type of regulation. There is no doubt that distribution networks provide a clear monopoly service and the costs of light regulation that are now being recommended in the draft report increase the costs of pipeline operation (as they do for non-scheme pipelines) so that the saving of regulatory costs from

⁹ The MEU points out that as retailers pass through gas transportation costs, it is unlikely that any one retailer would institute an arbitration process as the benefit would be available to any other retailer providing no benefit to the instigation retailer

¹⁰ The MEU notes that one of the major elements in a regulatory proposal was the arguments provided by pipelines for an increased rate of return, so the costs of full regulation will fall considerably

applying light regulation are much reduced and probably do not offset the disadvantage to consumers by not having full regulation.

The MEU considers that the failure of the AEMC in assessing the cost impact on the new light regulatory process of the changes it proposes overlooks that the differential which justified the granting of light regulation have now dissipated considerably.

5. Negotiate-arbitrate regime represents an appropriate balance – or does it?

The AEMC states (page 7)

“...the regulatory framework applied to scheme pipelines is incentive-based, with an underlying reliance on the use of negotiation and arbitration.”

The MEU has a fundamental issue with this concept – not so much about the incentive regulatory approach but about the concept that there is an underlying reliance on negotiation and arbitration. There are two main issues with the concept.

Firstly, there is an assumption that a shipper (whether a retailer or end user) is sufficiently well resourced and well informed to be able to undertake negotiations on a relatively even basis. This may be true but the assumption made by the AEMC (page 33) that

“[s]ome may have a degree of countervailing market power. These factors serve to constrain (to a degree) the extent of market power of pipeline owners”

has not been the experience of MEU members, even those with very large balance sheets which significantly exceed those of pipeline owners. It has been made abundantly clear to large end users that monopoly provides a massive advantage in any negotiation, to the point that negotiation is impossible¹¹.

Secondly, this concept implies that the party that ultimately pays for the service can directly interface with the pipeline owner. However, the large majority of consumers have to operate through a retailer which contracts with the pipeline owner for shipping services. What consumers see is the pass through of the costs that the retailer incurs in delivering the “bundled” service of gas provision. In fact, even MEU members that use a retailer have attempted to negotiate with pipeline owners for the transportation service have been advised by the service provider that it does not have to negotiate with the end user as it is with the retailer/shipper that the service provider contracts.

¹¹ One MEU member refers to a discussion with one pipeline owner during a “negotiation session” where the service provider stated – “If you don’t like what we propose, go and build a new pipeline which we know will cost you more than the price we are asking for”

While the AEMC does imply that the changes recommended in its report will provide a benefit to consumers (as consumers are the focus of the NGO) the actual operation of the changes will be through these retailer/shippers and there is no imperative on them to ensure that the costs of gas transportation are minimised, as all “pass through” the costs of the regulated services. A review of regulator reset processes for regulated pipelines show that few retailers get involved in the reset process and where they do, the focus of their involvement is mainly on the non-tariff elements rather than on the tariffs that are set.

While very large end users of gas have entered into direct negotiations with pipeline owners even when getting their gas through a retailer, smaller consumers of gas have expressed concern that either they do not have the leverage or financial resources to utilise the negotiate-arbitrate approach or are unaware that this option is available to them.

The MEU also questions whether there is much “negotiation” carried out for services other than the reference services due to the benefit that an end user might get from any changes to a tariff proposed by the service provider. The MEU considers there is value in further investigation as to the extent of any “negotiation” for non-reference services that has occurred compared to where an end user has sought a tariff for a non-reference service and effectively had to accept the offer due to a lack of better information and limited rights to arbitration.

With this in mind, the MEU questions whether the concept that the “negotiate-arbitrate” approach has real value for consumers.

6. Extensions and expansions

The MEU notes that the draft report considers that there should be no constraints on regulatory discretion applying to extensions and expansions – the MEU agrees that regulators should not be prevented from exercising such discretion.

While supportive of the changes proposed by the AEMC with regard to expansions and extensions, the MEU is concerned that the ability of a service provider to readily change from one type of regulation to another type which is less arduous, the reverse applies for end users to move the type of regulation to one beneficial to consumers is heavily limited (see section 4 above). This is important as, while the AEMC considers that an augmentation to a regulated pipeline should also become regulated, this does not apply to extensions where the service provider effectively has the option to determine the type of regulation that will apply.

This same issue applies to expansions and extensions in that the service provider has a low hurdle to cross in moving to a less arduous type of

regulation. The MEU considers that for the same reasons explained in section 4, there is a need for a similar low hurdle for end users to use in order to impose more arduous regulation when needed.

The MEU notes that it is within the purview of the service provider to either have an extension included with the other regulated assets or excluded whereas a consumer would have to go through an extensive coverage process to seek regulation of the extension. This bias imposes a significant hurdle for consumers. The MEU considers that the AER should have the discretion to over-ride the decision of the service provider on whether an extension should be regulated or not.

7. Reference services

The AEMC provides considerable discussion about the role of reference services and opines that these reference services could provide the basis for a negotiation between end-user/shipper and the service provider. While the concept has some value, it is the implementation of such a negotiation where the concept starts to fail. As noted above, the concept of negotiation with a monopoly service provider has been demonstrated to be fallacious in that the service provider has all of the necessary information and the market power.

The second fallacy comes about as the service provider has everything to lose if a “negotiation” leads to a lower price for the service, whereas the prospective user has to balance the cost of such negotiation (and any subsequent arbitration) against the potential benefit that might arise. This means that the drivers in a negotiation impose more desire to “win” with the service provider who has every thing to win and little to lose, whereas the end user/shipper has to balance the costs of the negotiation and any subsequent arbitration against the likely benefit.

The third fallacy lies with the fact that, for the bulk of all transport, it is the retailer that is the prospective shipper and for a regulated pipeline, the benefit that a retailer might gain from a “negotiation” will be available to any other retailer, thereby providing the initial prospective shipper (retailer) with little to gain from any investment it makes in seeking a better outcome for itself or its customer.

A fourth fallacy comes from the observation made by a number of MEU members where a user seeking to transport gas via a retailer, can be prevented by the pipeline owner from direct negotiations as the pipeline owner can decide not to negotiate with the end users as it will be the retailer that will be contracting for the transport rights.

As a result of these realities, it is clear that reference services are effectively the only services that are used for the vast majority (if not all) gas transportation.

With this in mind, the MEU considers that the approach to setting which reference services are to be provided by a service provider, needs to be made more explicit.

In particular, the MEU considers that the changes contemplated by the AEMC should be expanded to allow for end users of the gas transported, to be able to nominate additional reference services. The changes proposed by the AEMC imply that a pipeline owner is able to nominate what reference services it considers are appropriate and that the AER will consider these in its analysis. The changes also seem to imply that the AER might decide that there should be other reference services.

The MEU considers that the decision about the reference services to be made available should explicitly state that end users and shippers may nominate reference services that they consider should be implemented and for the AER to be required to consider these nominations. The MEU also considers that the AER should be required to develop a guideline to provide clarity about the criteria it will use to determine whether a pipeline service will be mandated to be a reference service.

The MEU considers that the expansion of the number of reference services that are fully detailed and available will assist in limiting the need for negotiation and, potentially, arbitration.

8. Access arrangements

The MEU notes that the changes proposed by the AEMC include for the regulation to be under one of three basic forms of regulation – revenue cap, tariff basket price control, revenue yield control or a combination of the three.

However, a constraint of these options lies within the power of the service provider, in that it is the service provider that makes the decision on the form of regulation it wishes to utilise. In contrast, under the NER, it is the decision of the regulator to determine the form of regulation.

With the potential increase in the number reference services to be used, the MEU is concerned that the service provider will use the form of regulation that maximises the revenue that the service provider gains. The MEU notes that one of the reasons the AER moved from price cap regulation in the transport of electricity to a revenue cap approach, was driven, in part, by the ability of the networks to “game the system” and so gain greater revenue than the AER considered was appropriate when considering the investments made and current conditions for the cost of capital.

With this in mind, the MEU considers that the regulator should have the power to set the form of regulation that is to be applied to a gas transportation system,

and that the regulator should undertake a process similar to the “framework and approach” to the regulation as used under the NER to determine the form of the regulation to be applied.

The MEU is aware that service providers use the non-price terms and conditions for access as well as the penalties for transgressions as a significant form of unregulated revenue gathering. There is no certainty that the penalties for transgressions (eg for exceeding MDQ/MHQ, imbalances, etc) reflect the costs incurred by the service provider yet there is limited investigation as to the benefit that service providers garner from excessively high priced penalties, and whether these penalties lead to over-recovery of the revenue considered to be appropriate for the services provided.

For example, the MEU is aware that in gas distribution networks, the service provider uses a ratcheting process for setting the MHQ for each user as the basis of a reference service. While the MEU considers that the transgressor should be subject to some form of penalty because increasing MHQ results in misallocation of costs between all users, the ratcheting process allows the service provider to gain increased revenue without incurring any additional cost. Similarly on a transmission pipeline, exceeding MDQ incurs a penalty but as the full cost of a regulated pipeline is recovered by the reference tariffs, this penalty increases the revenue at no cost to the service provider.

The MEU is concerned that the gaming of tariff averaging and imposition of excessively high penalties for transgressing conditions has provided gas transportation service providers with a benefit that could be better addressed by the AER having the power to determine the form of regulation to be used, or by service providers having to fully substantiate the size and imposition of penalties for transgressions of non-tariff terms and conditions and how this revenue is reallocated back to consumers.

As the AEMC describes in its draft report, there is a need to have standardised terms and conditions if there is to be the ability to trade capacity of a pipeline. The use of these standard terms and conditions for the sale of all capacity (including that for reference services) would be a significant benefit to all end users of gas and to shippers acting on their behalf.

Subject to the issues raised above, the MEU supports the other changes proposed by the AEMC for the reasons used by the AEMC

9. Determining efficient costs

The MEU is concerned that there is a difference in approach to setting the capital base between Part 23 and Part 9 of the NGR. While the wording of the setting of the initial capital base is the same in both Part 9 (clause 77) and Part 23 (clause 569), there is the ability of the regulator under Part 9 to include an inflation component in setting the current depreciated value of the assets.

Specifically, the MEU notes that the AER applies the depreciated replacement cost methodology in rolling forward the capital base whereas Part 23 implies that the depreciated actual cost methodology applies to non-scheme pipelines.

While these different approaches do not necessarily create conflict under normal operations, this differential has the potential to create conflict in the event that regulation a pipeline transitions from one type to another type of regulation. This difference has the potential to impact whether the service provider or shipper seeks one type of regulation over another, regardless of the merits of whether such a change should occur for reasons of market power.

For example, where a service provider has an extension to a scheme pipeline but which was regulated as a non-scheme pipeline, there is an incentive for the service provider to move the extension to be a scheme pipeline as this would allow the extension to be valued on a depreciated replacement cost basis rather than on a depreciated actual cost basis. As the AEMC proposed changes to the rules provide an easy transition for an expansion or an extension from non-scheme to scheme at the discretion of the service provider, the difference between the two sets of rules can provide an important influence to the decisions made by the service provider about the regulatory approach to be used (eg non-scheme or scheme), even though it might not be in the interests of end users.

While the MEU supports the concept that speculative investment might be able to get an equal or even higher rate of return than that applying to regulated assets, the MEU is concerned how this would be applied in practice. The AEMC should provide greater guidance in the rules how the process of allowing speculative investment is to be managed and what risk allowances the AER should be required to incorporate in a higher rate of return for speculative investment that is later rolled into the asset base.

Subject to the comments above, the MEU supports the changes proposed by the AEMC for the reasons suggested.

10. Negotiation and information

The MEU points to the comments made in the sections above regarding negotiation, as the MEU considers that the reality when entering into negotiations with a monopoly service provider is fraught. However, it is clear that the AEMC still considers that a few “tweaks” to the rules will be sufficient to change the balance between the parties when one has market power.

As the AEMC does point out, information asymmetry between service provider and all others involved in the process (including the regulator, end users and shippers) provides the service provider with not only having a monopoly position

to operate from but also to control the flow of information which might otherwise be used to moderate its monopoly position.

In recent years, the MEU has been pleased with the development of the provision of data that has been required by the regulator of electricity networks through the Regulatory Information Notices (RINs) and the amount of useful information that is now provided on an annual basis through the Economic Benchmarking RINs, the Category Analysis RINs, and Annual Reporting RINs. These new sources have provided end users with a considerable amount of information which has tended to redress the information asymmetry that existed before these requirements were made compulsory.

Prior to the requirement to provide this RIN data, end users were constrained to gather data from previous access arrangement processes and to collate this information into a usable format. Unfortunately, the lack of RIN data of a similar nature to that provided by electricity networks has severely limited the ability of end users to be as active in gas network regulation as in electricity regulation.

The MEU is not convinced that the information asymmetry imbalance will be sufficiently addressed by the changes proposed by the AEMC. While better than what is currently available, the changes are considered to be insufficient for the needs of end users and shippers.

The MEU points out that there is a significant amount of information provided at each access arrangement reset but this could be made more useful to consumers if such information was provided on an annual basis and in a more usable format.

One of the major omissions from the introduction of regulation for non-scheme pipelines is the provision for benchmarking of performance and the divulging of costs. The MEU considers that for regulated (both full and light) pipelines there should be the requirement to provide information to assist the AER, shippers and end users to identify the costs of providing the services and by doing so, develop a tool for benchmarking the performance of the service providers of each pipeline and between pipelines.

For example, pipeline owners often use both capital and operating costs with reference to the diameter.length metric. In its proposal for the Amadeus Gas Pipeline, APA makes reference to its opex in terms of this metric. In its regulatory decision on the Dawson Valley Pipeline, the ACCC carried out non-capital cost comparisons based on a percentage of the optimised replacement cost of the asset.

It is the provision of useful information such as this (especially cost information and benchmarking) that are essential to providing a countervailing force to encourage a viable negotiation process. The MEU considers that data as in the electricity market network RINs (especially the economic benchmarking RINs) is

an appropriate basis for establishing the minimum requirements for provision of information for gas transportation.

While the MEU notes that the AEMC considers that the regulator has sufficient powers to seek the sort of data that the AER obtains in the case of electricity networks, the fact that the regulators have not sought such information for gas transport is intriguing and the MEU considers that perhaps the information gathering powers of the regulator in the case of gas transport is not as strong as the AEMC purports in its assessment. The AEMC considers that as the regulators have sufficient powers for data gathering (eg via RINs and RIOs) there is no need to require gas transportation to provide KPIs.

The fact that the AEMC considers that the rules should be changed to require additional information to be provided supports the MEU view that perhaps the regulators do not have sufficient powers to gather the information that is needed. With this in mind, the MEU questions whether the decision not to require KPIs is sensible and whether the lack of these will disadvantage end users of gas transportation services.

11. Arbitration

Subject to the comments provided above (especially in sections 4 and 5), the MEU supports the changes proposed by the AEMC for the reasons given in the draft report.

12. Summary

The MEU considers that most of the recommendations included in the draft report should be implemented and, as a result, the regulatory process will improve the National Gas Rules and in the process provide consumers with an outcome that will be more in their long term interests.

However, as highlighted in the foregoing commentary, the MEU considers that there are conclusions drawn by the AEMC in the draft report that should be reconsidered when the observations made by the MEU are fully assessed. In summary these are:

1. There is a fallacy behind the concept that providing tools for better consumer interaction with service providers, as funding for consumer involvement is extremely limited, reducing the value of the new tools being made available
2. There are reservations about the efficacy of the new Part 23 rules in achieving an outcome that is in the long term interests of consumers so using Part 23 requirements as a guide might not be sufficient to maintain the focus on consumers' interests.

3. The draft report should recommend changes to coverage criterion (a) to reflect the recommendation of the ACCC about coverage. The MEU considers that service providers have an easy the ability to move from one type of regulation to another but end users will have considerable difficulty in proving a competition benefits test¹², and the costs involved will impose a barrier to consumers seeking the best outcome
4. Light regulation should be removed, especially in the case of distribution networks, as the imposition of the new requirements for lightly regulated pipelines considerably reduces the cost of not having full regulation, but the benefits to consumers will be significant
5. The view that the negotiate-arbitrate form of regulation is appropriate is not supported when considering the barrier to consumer involvement due to the costs of negotiating and arbitrating compared to the benefits to consumers of full regulation
6. For most end users, the contract arrangements for gas transport are between retailer/shippers and the service provider, effectively reducing the ability of end users to influence outcomes
7. There is conflict between the Part 9 rules (for scheme pipelines) and Part 23 rules (for non-scheme pipelines) especially in relation to assessing the capital base. This has the potential for service providers to seek the regulatory approach that maximises their revenues
8. There should be an explicit requirement for development of economic benchmarking, category analysis and annual reporting such as applies to electricity networks

The MEU provides the following abbreviated comments on each the AEMC draft recommendations posed in its issues paper. The MEU notes that these responses should be seen in context with the observations provided in the earlier part of this response

	Draft Recommendation	MEU comment
1	Include all expansions in an access arrangement	Supported
2	Remove regulator’s discretion to exclude an expansion from light regulation	No. The regulator should retain discretion for all aspects of an access arrangement
3	Enable existing extensions to be included in access arrangements	Supported, although the MEU considers that consumers should also be able to seek inclusion of an extension into the access arrangement without having to go through the coverage process

¹² Even under a with/without test

4	Clarify the requirements for defining pipeline services	Supported
5	Clarify the requirements for defining reference services?	Supported
6	Update the test for determining a reference service	Supported
7	Introduce a reference service setting process	Supported, but end users must have a say on what reference services they need
8	Develop financial models to be used by service providers	Supported
9	Clarify the operation of revenue caps	Supported, noting that it must be the regulator that determines the form of regulation
10	Clarify that the regulator is to have regard to risk sharing arrangements	Supported
11	Extend the revision period	Supported
12	Clarify the process for equalising revenue during the interval of delay	Supported
13	Remove the limited and no discretion regulatory framework	Supported
14	Clarify the application of the new capital expenditure criteria	Supported, all capex must be prudent for it to be allowed into the asset base
15	Provide guidance on the allowed return for speculative capital expenditure	Supported
16	Clarify the term depreciation when used in capital base valuations	The MEU considers that there must be consistency in developing the asset bases
17	Require an initial capital base valuation for light regulation pipelines	Distribution networks should be fully regulated, so development of an initial capital base is needed for these networks. Lightly regulated transmission lines should have an initial asset base set
18	Enable the addition of existing extensions and expansions to the opening capital base	Supported subject to comments made above
19	Require allocation of expenditure between covered and uncovered parts of a pipeline	Supported
20	Amend definition of rebateable services and rebate methodology	Supported

21	Require transmission pipeline service providers to disclose Bulletin Board information	As noted above, the MEU considers that this approach is not sufficient and that additional reporting is needed
22	Require distribution pipeline service providers to disclose capacity and usage information	As noted above, the MEU considers that this approach is not sufficient and that additional reporting is needed
23	Clarify the role of the regulator in passing on information requests to service providers	The MEU considers this change may not be in the interests of consumers, especially as the service provider has the power over the flow of information
24	Introduce a financial and offer information disclosure regime for light regulation pipelines	Supported in general but the MEU considers that distribution networks should be fully regulated and so the information disclosed should be that for a fully regulated network
25	Remove the requirement to provide KPIs as part of the access arrangement	Not supported. See comments above
26	Improve the Scheme Register	Supported
27	Amend trigger for dispute resolution process	While the process for triggering a dispute is supported, the MEU considers that the concept of negotiate/arbitrate is a barrier to end users, especially small end users
28	Clarify the role of the dispute resolution expert	Supported
29	Establish a reference framework for the dispute resolution body	Supported
30	Introduce a fast-tracked dispute resolution process	Supported in general, but the MEU has concerns that it might have a negative impact on end users and shippers as the information asymmetry allows the service provider to respond faster than an end user or shipper, putting the end user or shipper at a distinct disadvantage
31	Publish dispute resolution commencement, outcome and other information	Supported
32	32: Enable joint dispute resolution hearings	Supported, but the MEU notes that parties that should be allowed to join should include advocacy groups and other interested end users of the services under assessment.
33	Clarify the definition of rule disputes under the NGL	Supported

