10 April 2018

Mr John Pierce AO
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Submitted via the AEMC website

Dear Mr Pierce,

**AEMC draft report: Review into the scope of economic regulation applied to covered pipelines (GPR0004)**

The National Competition Council (NCC) is pleased to provide the attached submission to the AEMC’s draft report for its review into the scope of economic regulation applied to covered pipelines.

The NCC welcomes the opportunity to further engage with the AEMC in the coming months as it develops its final report.

If you would like to discuss any aspect of this submission, please do not hesitate to contact Richard Home on (03) 9290 6960 or richard.home@accc.gov.au.

Yours sincerely

Julie-Anne Schafer
NCC President
1 Summary

1.1 This submission sets out the NCC’s views in relation to the issues raised in Chapter 3 of the AEMC draft report.¹

1.2 In summary, the NCC:

- supports the continued use of the negotiate-arbitrate model for regulated access to natural gas pipelines in Australia;
- supports the AEMC’s proposal to change full and light regulation by more closely aligning them to Part 23 of the National Gas Rules (NGR) in terms of information disclosure obligations and the arbitration mechanism, in order to promote consistency;
- does not support the option proposed by the AEMC to re-design the regulatory framework (as outlined in Chapter 3), but has put forward an alternative approach for the AEMC’s consideration; and
- recommends the AEMC give further consideration to whether greenfields pipelines subject to a 15 year no-coverage determination should be automatically exempted from the Part 23 regime.

2 Background

Gas access regime before Part 23 – rationale for regulation

2.1 Since its inception in 1997, the regime governing access to natural gas pipelines in Australia evolved in response to various reviews, but always maintained broad consistency with the National Access Regime (NAR) in Part IIIA of the Competition and Consumer Act 2010 (Cth). The NAR was established following recommendations in 1993 of the Committee of Inquiry chaired by Professor Fred Hilmer (Hilmer Committee).² The Hilmer Committee’s recommendations were directed to the ‘essential facilities problem’: the economic problem created by a facility which could not be duplicated economically, and access to which was required by third parties in order to compete effectively in upstream or downstream markets.³ According to the Hilmer Committee,

An "essential facility" is, by definition, a monopoly, permitting the owner to reduce output and/or service and charge monopoly prices, to the detriment of users and the economy as a whole. In addition, where the owner of the facility is also competing in markets that are

¹ AEMC draft report, Review into the scope of economic regulation applied to covered pipelines, February 2018.
² Commonwealth of Australia, National Competition Policy (Hilmer Report), August 1993.
dependent on access to the facility, the owner can restrict access to the facility to eliminate or reduce competition in the dependent markets. 4

2.2 The owner of an essential facility who is not competing in dependent markets (i.e. is not vertically integrated) may not have an incentive to deny access to a service. 5 However, a non-integrated service provider may have an ability and incentive to charge monopoly prices that adversely affect competition in dependent markets resulting in inefficiencies and welfare loss. 6

2.3 Natural gas pipelines typically have natural monopoly characteristics (e.g. large, sunk investment7 and economies of scale), which could serve as barriers to entry. 8 However, that does not necessarily mean that they all have substantial and/or enduring market power warranting regulation, as there may be factors that could constrain the exercise of their market power (e.g. competition with other pipelines, countervailing market power of shippers, and availability of substitute fuels). 9 To that end, the coverage criteria (a) and (b) were designed to consider and test for market power, a threshold trigger for whether coverage (regulation) should be applied.

Gas access regime before Part 23 – the role of the coverage criteria

2.4 The coverage criteria also encompass other important elements, such as the public interest covered by criterion (d). An assessment of the public interest would necessarily require a consideration of the benefits as well as the costs of regulation.

2.5 It is well recognised that access regulation has costs. It is an intrusive form of regulation, 10 overriding private property rights and mandating the owner or the service provider to make its facility available to third parties on terms and conditions (including price) determined by the regulator. 11 Access regulation imposes regulatory costs/burden, and could distort dynamic efficiency and discourage infrastructure investment, given the risks associated with investment 12 and the possibility of low access prices being set. 13

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4 Hilmer Report, pp. 239-240.
7 Sunk cost refers to costs that are at risk of not being able to be recovered once they are incurred – for example, the large costs of building a new pipeline that cannot be recouped if the investment proves to be unsuccessful.
10 Commonwealth of Australia, National Competition Policy (Hilmer Review), August 1993, p. 248
2.6 The coverage criteria were designed to limit regulation only to circumstances where the benefits arising from the promotion of competition in dependent markets would demonstrably outweigh the costs.\textsuperscript{14}

2.7 In giving effect to the coverage criteria, the NCC and the relevant Minister are required have regard to the national gas objective (NGO). The NGO directs attention to the long-term interests\textsuperscript{15} of consumers by promoting \textit{efficient investment in}, and efficient use and operation of, natural gas services.\textsuperscript{16} The NGO is recognition of the importance of balancing the productive, allocative and dynamic efficiencies in the provision of pipeline services as well as in upstream and downstream markets—where competition is a key driver of welfare gains.\textsuperscript{17}

2.8 The NCC notes that the AEMC has suggested a potential option to modify the application of the coverage determination process, in light of Part 23 of the NGR.\textsuperscript{18} This is discussed in paragraph 5.12 below.

\textbf{Gas access regime before Part 23 – regulatory design}

2.9 Prior to the introduction of Part 23, access regulation only applied to pipelines that were subject to a coverage determination (i.e. ‘covered’ pipelines). Access to ‘uncovered’ pipelines, or greenfields pipelines that have been exempt from coverage for 15 years,\textsuperscript{19} was a matter for private negotiation without recourse to a regulator.

2.10 A coverage determination on a new pipeline would essentially involve the following steps.\textsuperscript{20}

\textsuperscript{14} More specifically, the decision-maker is required to balance the potentially competing goals of promoting competition in related markets and ensuring appropriate investment incentives, and to consider the likely effectiveness of regulation and its costs.

\textsuperscript{15} The words “long term” are included as a caution against focussing on short term benefits to consumers which may undermine longer term investment and welfare gains.

\textsuperscript{16} In the Second Reading Speech by the Hon. Mr Conlon, MP, for the \textit{National Gas (South Australia) Bill 2008}, South Australia, Legislative Assembly, 9 April 2008, pp 2884-2916, Mr Conlon stated that “if gas markets and access to pipeline services are efficient in an economic sense, the long term economic interests of consumers in respect of price, quality, reliability, safety and security of natural gas services will be maximised. By the promotion of an economic efficiency objective in access to pipeline services, competition will be promoted in upstream and downstream markets.” It should be noted that the NGO is similarly worded to one of the objects of Part IIIA, i.e. “promote the economically efficient operation of, use of and investment in the infrastructure...thereby promoting effective competition in upstream and downstream markets” (s. 44AA, CCA).


\textsuperscript{18} AEMC draft report, pp. 43-47.

\textsuperscript{19} See further discussion in paragraphs 5.46-5.51.

\textsuperscript{20} There are other pathways to coverage – pipelines that were covered under the Gas Code, pipelines that have been constructed through a competitive tender process approved by the regulator (s.126, NGL) and pipelines for which the service provider has submitted a voluntary access arrangement to the regulator (s.127, NGL).
First, a right of access would be created by a coverage determination made by the relevant Minister, based on an NCC recommendation, that a pipeline satisfies the coverage criteria and should be covered.

Second, the NCC would decide whether to make a light regulation determination (i.e. whether the pipeline should be subject to full or light regulation21). The NCC’s decision on the form of regulation determines the extent of regulation to apply to the pipeline; and affects the way prospective shipper(s) negotiate with the service provider on the terms and conditions of access.22 If negotiations fail, the parties could seek arbitration by the regulator.

2.11 While full and light regulation impose many similar obligations on the service provider,23 the distinguishing feature of full regulation is the requirement to submit an access arrangement to the regulator24 for approval. On the other hand, light regulation emphasises commercial negotiation and information transparency to facilitate access to pipelines.

2.12 In deciding whether to make a light regulation determination, the NCC must consider which form of regulation would likely be the most effective at least cost, taking into account the form of regulation factors, the NGO and any other relevant matter.25

2.13 The NCC notes that the AEMC has suggested a potential option to modify the framework described above, in light of Part 23 of the NGR. This is discussed in paragraph 5.12 below.

3 New regime for non-scheme pipelines (Part 23 of the NGR)

3.1 Prior to 1 August 2017, coverage (regulation) was granted on a case-by-case basis through a coverage determination process. However, the introduction of Part 23 means that pipelines that were previously not subject to any access regulation are now all subject to a form of regulation26 that is similar in nature to light regulation. In effect, Part 23 has bypassed the coverage criteria as the gateway to regulation and, in effect, deemed all ‘non-scheme’ pipelines (except for those that do not provide third party access) as requiring of regulation, based on the assumption that they all have market power.

21 The NCC may make a light regulation determination either in conjunction with its coverage recommendation in respect of a pipeline (s. 110(2)(a), NGL); or, if the pipeline is already a covered pipeline, upon application from the pipeline service provider (ss. 111-114, NGL).

22 Under full regulation, the regulator approves the access arrangement relating to the terms and conditions of access, including price, for at least one ‘reference service’ likely sought by a significant part of the market. However, uses may negotiate terms and conditions for services that are different to the reference service.

23 Sections 131 to 148, NGL.

24 The AER is the regulator in all states and territories except in WA. In WA, the ERA is the regulator.

25 Section 122, NGL.

26 Within the Part 23 regime, there are three more forms of regulation based on the circumstances of the pipeline: a single shipper pipeline, a pipeline with daily capacity of less than 10TJ, and a pipeline that is not a single shipper pipeline and has daily capacity of above 10TJ.
3.2 The term ‘non-scheme’\(^\text{27}\) encapsulates existing pipelines that are uncovered, greenfields pipelines subject to a 15 year no-coverage determination\(^\text{28}\), and any new pipelines that have not been subject to coverage. The only uncovered pipelines that are fully exempt from the operation of Part 23 are pipelines that do not provide third party access.

3.3 At its heart, Part 23 is similar to light regulation. Both are negotiate-arbitrate models that give primacy to information disclosure and commercial negotiation to facilitate access to pipelines, subject to the threat of arbitration.

**Background to Part 23**

3.4 The NCC understands that the impetus for Part 23 came from the ACCC’s east coast gas inquiry\(^\text{29}\) (April 2016) and Dr Vertigan’s examination\(^\text{30}\) of the test for the regulation of gas pipelines (December 2016), which found that the coverage criteria were not designed to address and did not constrain, the apparent monopoly pricing behaviour of transmission pipelines.\(^\text{31}\) Subsequently, the COAG Energy Council decided not to amend the coverage criteria, but instead introduced a new information disclosure and commercial arbitration framework applying to non-scheme pipelines.\(^\text{32}\) This framework, which was developed by the Gas Market Reform Group (GMRG), took effect through Part 23 of the NGR and commenced on 1 August 2017.

3.5 Before Part 23 came into existence, in November 2016, the NCC provided a submission to Dr Vertigan offering its views on the issues raised in the ACCC inquiry. In light of the AEMC draft report raising similar issues, the NCC would like to offer the following views consistent with its previous submission to Dr Vertigan regarding the coverage criteria:

- Persistent monopoly pricing is sign of significant barriers to entry, and/or enduring market power. Consideration of such issues is already included in criterion (a), as is consideration of whether the service provider has the ability and incentive to use that market power to adversely affect competition in a dependent market.\(^\text{33}\) The fact that most gas pipelines are not vertically integrated\(^\text{34}\) does not make criterion (a) less relevant. Criterion (a) will be satisfied where it could be shown that the access (or

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\(^{27}\) ‘Non-scheme’ pipeline is defined as a transmission or distribution pipeline that is not a ‘scheme’ pipeline (ss. 216A and 216C(1), NGL). A ‘scheme’ pipeline is defined as a covered pipeline or an international pipelines to which a price regulation exemption applies (s. 2, NGL).

\(^{28}\) This is further discussed in paragraphs 5.46-5.51 below.


\(^{30}\) *Examination of the current test for the regulation of gas pipelines*, December 2016.


\(^{32}\) This follows from Dr Vertigan’s recommendations but with amendments.


\(^{34}\) Pipelines subject to full and light regulation must comply with structural separation requirements (i.e. ring-fencing obligations). However, pipelines subject to Part 23 do not have similar requirements. See further discussion in paragraph 5.10.
increased access) allows for competition to drive efficiencies gains in a related market, consistent with the efficiency focus of the NGO.

- Persistent monopoly pricing may trigger circumstances that could meet the coverage criteria. However, it was not clear to the NCC whether the monopoly pricing behaviour observed by the ACCC in its east coast gas inquiry report (if, and to the extent that it was occurring) was permanent or transitory.

- In response to views that the coverage criteria could be hard to satisfy, the NCC notes that there have been few pipeline coverage applications lodged with the NCC to test that proposition.\(^{35}\) In any event, regulation has significant costs, and was never intended to be applied unless the benefits were substantial and could not be achieved by other interventions or waiting for transitory distortions to dissipate. For these reasons, the NCC does not consider the coverage criteria should be amended as proposed by the ACCC.

3.6 However, with the introduction of Part 23, the regulatory framework has significantly changed with non-scheme pipelines, in effect, deemed to require regulation by a commercial negotiate-arbitrate model. These changes have implications for how the pre-existing regulatory elements interact with Part 23. These issues were not able to be considered by the GMRG during the short timeframe in which Part 23 was developed,\(^{36}\) but are now being examined by the current AEMC review.

4 \textbf{NCC – high-level comments on Part 23}

4.1 Putting aside the question of whether all non-scheme pipelines should be regulated under Part 23 without an assessment under the coverage criteria (that having been decided by the respective Commonwealth, state and territory governments), at the outset, the NCC wishes to note that it supports the negotiate-arbitrate model underpinning the new Part 23 regime. Specifically, the NCC commends the emphasis of the regime on information disclosure, and on using an arbitration mechanism to facilitate private commercial negotiation between pipeline service providers and shippers. The obligations on pipeline service providers to disclose information should improve transparency, reduce transaction costs, and address any imbalance in bargaining power that might exist.

4.2 However, the Part 23 regime bears similarities to light regulation for covered pipelines. Part 23 contains an access regime (determined and enforced through binding arbitration), with an

\(^{35}\) Since the inception of the NCC, there have only been three applications for coverage made to the NCC.

expansive scope or reach. This means that it may not necessarily operate as a light-handed regime and regulatory costs could be expected to arise as a result.\(^{37}\)

4.3 While the NCC has reservations regarding the need and/or benefits of the blanket approach to regulation under the Part 23 regime, the NCC accepts that it was the view of the Commonwealth, state and territory governments that access regulation should be extended to non-scheme pipelines and to, in effect, bypass the coverage criteria.

5 NCC – specific comments on Part 23 and related issues

Aligning information disclosure and arbitration provisions

5.1 Some stakeholders raised concerns that full and light regulation pipelines appear to be subject to less stringent information disclosure obligations and less detailed arbitration mechanisms compared to those that apply to pipelines subject to Part 23.\(^{38}\) It was suggested that these regulatory inconsistencies were undesirable, and could lead to ‘forum shopping’.\(^{39}\)

5.2 To address those concerns, the AEMC has put forward draft recommendations to strengthen the information disclosure obligations and improve certain aspects of the arbitration framework in respect of full and light regulation (and in doing so, narrow the gaps between the three broad forms of regulation).\(^{40}\) The AEMC has proposed that these recommendations be implemented promptly, and in the meantime, it continue to explore its proposed option to re-design the regulatory framework.

5.3 The NCC provides in-principle support for these draft recommendations to be implemented as soon as possible, as it would be desirable to reduce the regulatory differences and promote consistency across different forms of regulation. However, the NCC is also cognisant that the enactment of Part 23 has raised questions as to whether light regulation should be retained at all, given it is highly similar to Part 23 in overall concept.

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\(^{37}\) The Gas Market Reform Group had intended that, “while the arbitration mechanism is a key element of the new framework, it is intended that commercial negotiation will continue as the principal means by which access terms and conditions are determined and that the arbitration mechanism will rarely be triggered.” Whether this outcomes eventuates should be the subject of a future review of the operation of Part 23.

\(^{38}\) Stakeholders also commented that in general, the arbitration framework for full and light regulation pipelines is of itself lacking clarity in some areas (e.g. the timeframes and process for conducting arbitration), and therefore should be improved.

\(^{39}\) That is, participants could seek out a particular regulatory model that they consider would give them their desired regulatory outcome. See the ACCC’s submission to Gas Pipeline Information Disclosure and Arbitration Framework Options Paper, 13 April 2017, p. 14; Hydro Tasmania’s submission to the AEMC issues paper, p. 2.

\(^{40}\) See Chapter 7 and 8 of the AEMC draft report.
The future role of light regulation

5.4 The NCC considers that in light of the introduction of Part 23, further consideration should be given to the idea of removing light regulation, as that may be the most straightforward way to streamline and simplify the overall regulatory framework. This would recognise the fact that in the long run, there will be inevitable tensions with keeping both light regulation and Part 23 together:

- Regulatory duplication – to the extent that light regulation overlaps with Part 23 and/or achieves a similar outcome as Part 23, there would be limited utility or justification in retaining light regulation.

- Regulatory inconsistency and disparity, which may lead to ‘forum shopping’ and potentially perverse outcomes. This is the reason that has prompted the current draft recommendations to be put forward to more closely align full and light regulation to Part 23 in terms of information disclosure requirements and some aspects of the arbitration framework.

5.5 These tensions are unlikely to disappear unless there is clear demarcation of the roles and functions between light regulation and Part 23, or that one of them is removed completely. While light regulation was originally intended for a portion of pipelines that are subject to coverage (i.e. those that do not have a higher level of market power justifying full regulation), Part 23 is now applicable to virtually all pipelines that are not subject to coverage.

5.6 By ‘deeming’ non-scheme pipelines to be regulated under a negotiate-arbitrate model that is similar to that for pipelines subject to light regulation, Part 23 has in effect bypassed the need to satisfy the coverage criteria in respect of non-scheme pipelines. Part 23 is now the default mechanism and provides a baseline level of regulation for almost all gas pipelines in Australia. Following 1 August 2017, any new pipeline is automatically subject to Part 23 and must comply with regulatory obligations that are similar to those under light regulation, without needing to be covered and subsequently go through the light determination process. Some submissions to the AEMC issues paper also noted that removing light regulation may have limited impact, given the introduction of Part 23.

5.7 The NCC is mindful that the transitional arrangements associated with the removal of light regulation would need to be considered. For example, a process would be required to transition existing light regulation pipelines to another form of regulation. However, the NCC does not believe these to be insurmountable challenges (see further discussion in paragraph 5.31).

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41 The exception is pipelines that do not provide third party access.
42 For example, AGL’s submission to the AEMC issues paper, 22 August 2017, p. 2.
Potential to improve Part 23

5.8 If light regulation is to be removed, the AEMC could consider improving Part 23 by incorporating any desirable features of light regulation. Just as light regulation could be amended to align with the more robust features of Part 23, Part 23 could also be amended over time to incorporate certain features of light regulation if they are desired.

5.9 Some pipeline users may prefer the arbitration mechanism under light regulation, as the regulator is the dispute resolution body and may join disputes and conduct hearings in public. On the other hand, arbitration under Part 23 is conducted by a commercial arbitrator, and the arbitrator’s rulings and determinations are confidential. Noting these differences between the (public) regulatory and (private) commercial arbitration models, the AEMC should consider why the differences should exist\(^\text{43}\), and the extent to which the differences are of sufficient importance to justify the retention of light regulation for covered pipelines.\(^\text{44}\)

5.10 The NCC also considers that there could be a strong case to amend Part 23 now, to incorporate the safeguards that have been in full and light regulation since the gas regime was first enacted – i.e. associated contract provisions and ring-fencing obligations to mitigate and control the risks of anti-competitive conduct by service providers.\(^\text{45}\) These safeguards are an important feature of the regulatory design,\(^\text{46}\) and should therefore apply equally to non-scheme pipelines subject to Part 23. The absence of these provisions from Part 23 may have been an oversight, rather than an intended design feature of Part 23.\(^\text{47}\)

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\(^\text{43}\) The effectiveness of the commercial arbitration mechanism in resolving access disputes under Part 23 could be informed through a review of Part 23, which is scheduled to be conducted in 2019.

\(^\text{44}\) However, see also paragraph 5.4 above.

\(^\text{45}\) For instance, prohibition against preventing or hindering access, prohibition on price discrimination, and ring-fencing obligations (e.g. not carrying on a related business, and keeping separate accounts for covered pipeline and consolidated business accounts).


\(^\text{47}\) Page 48 of the AEMC draft report states, “There are also some elements of light regulation which appear to be more suitable than Part 23 for certain types of pipelines in some circumstances. This includes ... a number of ring-fencing and other additional requirements...” (emphasis added).
The AEMC’s proposed option to re-design the regulatory framework

5.11 Part 23 only applies to non-scheme pipeline which does not include covered pipelines. The operation of Part 23 can therefore be ousted if a pipeline is determined to be a covered pipeline. In this situation the form of regulation in Part 23 will no longer apply but will be determined either as full or light regulation.

5.12 To avoid the potential for multiple regulatory schemes to apply to a particular pipeline, the AEMC has proposed an option to re-design the regulatory framework, so that going forward the following steps would apply upon an application being made to the NCC:

- Step 1: the coverage determination process would not apply to non-scheme pipelines subject to Part 23, but instead would only apply to pipelines exempt from Part 23 on the basis that they do not provide third party access. 48

- Step 2: if a pipeline provides third party access, it would bypass the coverage determination process and proceed to a form of regulation determination process. This would be analogous to the existing light regulation determination process, requiring the NCC to determine (on an assessment of the relative costs of regulation and the existing form of regulation factors, and having regard to the NGO), whether the pipeline should be subject to full regulation, light regulation or Part 23. The NCC’s decision (or the Minister’s decision49) in this regard would allow the pipeline to be moved between different forms of regulation.

5.13 The foregoing essentially reduces the coverage determination process to assessing only a small number of applications (i.e. coverage applications relating to pipelines that are exempt from Part 23), while increasing the use of the form of regulation determination process to assessing a potentially large number of applications (i.e. to re-determine what form of regulation should apply in respect of covered pipelines and Part 23 pipelines).

5.14 This option removes the need to apply the coverage criteria which, read in conjunction with the NGO, act to protect long term investment and welfare gains. Criterion (a) is an essential competition test designed to evaluate whether access (or coverage) would promote a material increase in competition in a dependent market; and criterion (d) clearly requires the public interest to be satisfied – e.g. the competition benefits resulting from access (or coverage) must be so substantial as to outweigh the costs of regulation (e.g. distortion of investment incentives due to regulatory burden and the risks of regulatory error). Criterion (b) also raises important economic considerations that go to the heart of why access regulation would be appropriate in specific circumstances, i.e. to avoid the costs of uneconomic duplication of pipelines.

48 The AEMC also envisaged that the other existing pathways to coverage (discussed at footnote 20) would continue to apply.

49 AEMC draft report, p. 44.
5.15 In effect, Part 23 has applied regulation to pipelines that have not been determined on the coverage criteria. However, the proposed option would essentially mandate an outcome that bypasses the need to apply the coverage determination process for the vast majority of pipelines going forward (except for the small number of pipelines exempt from Part 23). The NCC does not support this proposal on the basis that it could lead to full regulation being imposed with all of its attendant costs, without a robust assessment of the economically important considerations and the balance of interests raised by the coverage criteria.

5.16 There are also practical issues with implementing the proposal. Step 2 described above would require the NCC to predicate its decision on the form of regulation on the extent of the pipeline’s market power. That is, apply a heavier and more costly form of regulation (full regulation) to effectively regulate a pipeline with a higher level of market power, and apply a lighter and less costly form of regulation (either light regulation or Part 23) to a pipeline with less market power.

5.17 The NCC does not consider Step 2 to be practical. First, it is not clear to the NCC whether there are any clearly defined criteria for differentiating the level of market power between, or the market failure associated with, light regulation pipelines and Part 23 pipelines. These issues were not considered during the development of Part 23. It would be an almost impossible task to ‘grade’ the market power of a pipeline based on finer degrees of distinction than that currently exists. Such ‘grading’ would hardly be a bright-line test, and may result in greater regulatory uncertainty and higher costs (e.g. appeal costs) for the pipeline service providers and users.

5.18 Second, the existing light regulation determination was always designed to be a binary decision model, i.e. a pipeline would either be subject to full or light regulation. Similarly, the form of regulation factors have always been used to guide a decision towards either full or light regulation. It is difficult to see, in a practical sense, how the form of regulation factors could be ‘retrofitted’ to also apply to Part 23 pipelines, or be used to delineate market power or market failure further beyond the current binary design.

5.19 Attachment A sets out the form of regulation factors, and general considerations in respect of each factor.

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50 Gas Pipeline Information Disclosure and Arbitration Framework Final Design Recommendation, June 2017, at pp. 88-89, the GMRG noted that due to the accelerated pace in which the COAG Energy Council requested that Dr Vertigan’s recommendations be implemented, it did not have sufficient time to consider whether there would need to be any changes to light regulation in light of Part 23.

51 Under the Gas Code (the NGL’s predecessor), once a pipeline was covered, it would only be subject to full regulation. Light regulation was introduced when the NGL was enacted in 2008. This followed the recommendations of the Productivity Commission (2004) and the Expert Panel on Energy Access Pricing (2006) that light regulation should be available if there is less potential for significant inefficiencies to arise from the exploitation of market power.

52 In section 16 of the NGL.
5.20 Third, the existing light regulation determination process also requires consideration of the costs and effectiveness of full regulation versus light regulation. Under the proposed ‘form of regulation determination’ process, it is unclear how the NCC should go about assessing and comparing the costs and effectiveness of Part 23 compared to light regulation (given the similarity between them).

5.21 In summary, the NCC does not support the AEMC’s proposed option, as it could potentially lead to full regulation being imposed without having taken into account the economically important considerations and the balance of interests raised by the coverage criteria, and that because there are practical problems with implementing the proposed option.

Alternative approach

5.22 It is possible that, should light regulation be removed, the current light regulation determination process could be ‘repurposed’ to become one for determining whether a pipeline should be subject to either full regulation or Part 23. Essentially, this would be an analogous test to the current light regulation determination, except that light regulation is substituted by Part 23. The NCC could adapt the existing form of regulation factors to re-determine the level of regulation needed for a given pipeline, and move the pipeline to be under either full regulation or Part 23.

5.23 There is some overlap between the issues considered by the form of regulation factors and coverage criteria (a) and (b). That is, the extent of market power, which is both a threshold trigger for whether coverage should apply, and a relevant consideration in the choice of the form of regulation.

5.24 However, the NCC does not consider this alternative approach would be appropriate for the following reasons. First, it would have the practical effect of elevating the role of the form of regulation factors and relegating the role of the coverage criteria.

5.25 Second, abandoning the competition assessment test in criterion (a) and the public interest test in criterion (d) further diverges the gas access regime from the longstanding and well-established approach to infrastructure regulation established in Part IIIA of the CCA. This would not be an outcome that the NCC supports.

5.26 Third, the NCC considers that it is important that regard be had to future Ministerial involvement or input in determining the scope of regulation to be applied in the gas regime. Currently, while light regulation determinations are made by the NCC, the power to make coverage determinations rests on the relevant Minister acting on NCC advice. The role of the

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53 Section 122(1), NGL.
54 This approach may address the AEMC’s concerns that some pipelines may currently be subject to too much, or too little, regulation. Though, as pointed out on page 47 of the AEMC draft report, there is limited evidence of this issue at present, and the materiality of it is not yet clear.
Minister recognises that a politically accountable Minister is ultimately responsible for coverage decisions,\textsuperscript{55} which hinge on an assessment of whether coverage is in the public interest and whether the benefits of regulated access would outweigh the costs (criterion (d)). This requires the decision-maker to take account of and balance the competing goals of promoting competition in a dependent market (criterion (a)) and ensuring appropriate investment incentives. However, the relevant Minister is not required to be consulted by the NCC on the form of regulation decisions, as there is no need to consider the issues raised by criteria (a) and (d). Under the AEMC proposal, the decision required of the NCC would essentially be ‘administrative’ in nature (as there would no longer be any competition test and/or the broader public interest consideration),\textsuperscript{56} and it would be difficult to see any need for the Minister to be involved.

The NCC’s preferred approach to regulatory re-design

5.27 As noted in the preceding paragraphs, Part 23 has effectively deemed pipelines that previously fell outside the rubric of the gas access regime as regulated pipelines, on the assumption that they all have market power that warrant a level of regulation that is as intrusive, if not more intrusive, as light regulation. Part 23 is now the default option, providing a baseline level of regulation for the vast majority of pipelines in Australia. The exception is pipelines that do not provide third party access; following the introduction of Part 23, these are the only pipelines that are completely unregulated.

5.28 The NCC considers that going forward, the coverage determination process should be the gateway to determine if a pipeline (whether regulated under Part 23 or exempt) should be subject to either full regulation or Part 23.

5.29 In respect of pipelines regulated under Part 23, if it could be shown that Part 23 is not sufficient to constrain the market power or remedy the significant market failure associated with a particular pipeline, the following would apply:

- Full regulation would apply to the pipeline. That is, on receiving an application for coverage relating to a Part 23 pipeline, if the relevant Minister is satisfied (based on an NCC recommendation) that the pipeline meets all the coverage criteria, including that access would materially improve competition in related markets, the pipeline should become subject to full regulation.

- Consequently, the option to choose light regulation would be removed, as this reflects the reality that the pipeline is already subject to regulation that is similar to light

\textsuperscript{55} This was the intention of the Hilmer Committee, “as the decision to provide a right of access rests on an evaluation of important public interest considerations, the ultimate decision on this issue should be one for Government, rather than a court, tribunal or other unelected body. A legislated right of access should be created by Ministerial declaration under legislation”. Commonwealth of Australia, National Competition Policy (Hilmer Report), August 1993, p. 250.

\textsuperscript{56} Though the NCC would still have regard to the NGO.
regulation. In other words, the additional layer of applying the light regulation determination process and the form of regulation factors would also be removed.

5.30 Conversely, if it could be shown on an application that a full regulation pipeline no longer satisfies all of the coverage criteria, coverage would be revoked, and the pipeline would cease to be a ‘scheme’ pipeline\(^\text{57}\) and instead become a non-scheme pipeline regulated under Part 23. This process could be made consistent with the current process for revoking coverage,\(^\text{58}\) whereby anyone can lodge a coverage revocation application to the NCC, and the NCC (and the relevant Minister) are required to consider the pre-condition for revocation,\(^\text{59}\) i.e. whether or not all the coverage criteria are satisfied.

5.31 In regards to the removal of light regulation referred to in paragraph 5.29, consideration could be given to the idea of transitioning existing light regulation pipelines\(^\text{60}\) to the Part 23 regime, as that may be the least disruptive option taking into account the existing rights, interests and expectations of pipeline operators and users. Consistent with the above, if Part 23 is found to be insufficient to address the market power of the transitioned pipelines, coverage applications could be made to the NCC in respect of the pipelines, upon which the NCC and the relevant Minister would make an assessment of whether the pipelines satisfy the coverage criteria and should be subject to full regulation.\(^\text{61}\) If the coverage criteria are not satisfied, the pipelines would remain subject to Part 23.

5.32 Should light regulation be removed, it may be necessary to consider a process for pipelines currently exempt from Part 23 that are subsequently shown to satisfy all of the coverage criteria on a coverage determination, to ensure that the most appropriate form of regulation (i.e. Part 23 or full regulation) is applied to those pipelines.

**Benefit of this approach**

5.33 The NCC’s preferred approach outlined above would resolve the issue of ongoing tensions between light regulation and Part 23,\(^\text{62}\) and would be broadly consistent with the regulatory regime before light regulation was introduced in 2008.\(^\text{63}\)

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\(^{57}\) This is because, as mentioned in footnote 27, a covered pipeline is a ‘scheme’ pipeline. If a full regulation pipeline has its coverage status revoked, it will no longer be a covered pipeline and therefore no longer be a ‘scheme’ pipeline.

\(^{58}\) Section 102, NGL.

\(^{59}\) Sections 105 and 107, NGL.

\(^{60}\) According to the AEMC website, there are currently five light regulation pipelines. See https://www.aemc.gov.au/regulation/energy-rules/national-gas-rules/regulatory-classification-gas-pipelines

\(^{61}\) This could be beneficial, as circumstances may have changed since the light regulation determination was made (e.g. pipeline services may have become more, or less, contestable).

\(^{62}\) This is discussed in paragraphs 5.4-5.6 above.
5.34 But most importantly, it would continue to uphold the essential role of the coverage criteria as a ‘gate-keeper’, limiting the imposition of full regulation only in circumstances where it is clearly justified. In particular, there would be a competition assessment through the application of criterion (a), which could only be satisfied if it could be shown that full regulation would deliver a material improvement to competitive outcomes in a dependent market (relative to regulation by Part 23). There would also be a public interest test (criterion (d)) requiring that there be benefits of full coverage (i.e. remedying a market failure not able to be addressed by Part 23) that would clearly outweigh the additional regulatory burden associated with full regulation (relative to regulation by Part 23).

5.35 Further, the retention of the coverage criteria would ensure consistency of approach with the declaration criteria in Part IIIA of the CCA, upon which the coverage criteria were initially modelled.64

5.36 Part IIIA was originally enacted to provide a common framework and guiding principles to encourage a consistent approach to access regulation in each industry.65 And, as recognised by the Competition Policy Review (CPR) chaired by Professor Ian Harper, to this day:

“...Part IIIA continues to provide a legislative framework upon which industry-specific access regimes are based, acting as both a model and a ‘back stop’. Its legislative provisions are a model upon which industry specific access regimes have been developed. It also operates as a back stop to access regimes implemented through access undertakings accepted under Part IIIA (such as the ARTC rail track) or access regimes implemented under state and territory laws and certified as effective under Part IIIA. The undertaking and certification processes exempt the relevant facility from declaration under Part IIIA.

Accordingly, Part IIIA has an indirect role in supporting many industry-specific access regimes, even though its direct role is limited.”66

5.37 Prior to the CPR, the Productivity Commission (PC) also confirmed the importance of Part IIIA, and noted the benefits that it has brought in terms of achieving greater consistency in access regulation across the economy.67

5.38 The NCC considers that it is important to maintain consistency of the gas regime with Part IIIA as far as practicable, and would caution against further diverging the two regimes without giving careful consideration to the reasons or the ramifications.

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63 As mentioned in footnote 51 above, prior to the introduction of light regulation in 2008, it was the case that if a pipeline was covered it would only be subject to full regulation.

64 The commonality between declaration criterion (a) and coverage criterion (a) is that both are concerned with the promotion of effective competition in upstream and downstream markets, which is an explicit object of Part IIIA (s. 44AA(a), CCA).

65 Section 44AA(b), CCA.


The coverage criteria

5.39 In its draft report, the AEMC raised some potential concerns with the operation of the coverage criterion (a). Namely, that it does not address monopoly pricing issues, and that it could become harder to satisfy if the coverage criteria are aligned with the recently-amended declaration criteria in Part IIIA, particularly given the introduction of Part 23.

5.40 The NCC has addressed the issue of monopoly pricing in earlier sections. Regarding the hurdle posed by the coverage criterion (a), it is useful to provide a summary of how the interpretation of the declaration criterion (a) has evolved over time as a result of judicial interpretation, policy reviews and legislative amendments.

History of declaration criterion (a)

- Prior to 2006, the declaration criterion (a) was interpreted as requiring that declaration would *promote competition* in a dependent market.\(^68\) In its 2001 review, the PC raised concerns that this interpretation had set too low a threshold for declaration, as it meant that the criterion could be satisfied by a marginal or trivial increase in competition.\(^69\) In response to the PC’s concerns, the Federal Government amended the criterion to read “promote a material increase in competition”.\(^70\)

- In 2006, the Full Federal Court in the Sydney Airport matter\(^71\) held that ‘access’ in criterion (a) does not mean ‘declaration’. The Court considered that ‘access’ required a comparison of the future state of competition in the dependent market “with a right or ability to use the service and ... *without any right or ability* or with a restricted right or ability to use the service”.\(^72\) This overturned the NCC’s previous interpretation of the criterion, and significantly lowered the hurdle to satisfying criterion (a).

- In 2011, the Full Federal Court in the Pilbara Railways matter\(^73\) held that ‘access’ in criterion (f) is ‘access on such reasonable terms and conditions as may be determined in the second stage of the Pt IIIA process.’

- In its 2013 review, the PC considered that the decision in Sydney Airport had set the threshold for the criterion too low,\(^74\) and recommended restoring the interpretation of

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\(^68\) The declaration criterion (a) was worded as “access (or increase access) to the service would *promote competition* in at least one market...”.


\(^71\) *Sydney Airport Corporation Ltd v Australian Competition Tribunal and Others* (2006) 155 FCR 124; [2006] FCAFC 146.

\(^72\) Ibid, para. 83.

\(^73\) *Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* (2011) 193 FCR 57; [2011] FCAFC 58, [112].
the criterion to the position before Sydney Airport. That is, it should focus on the effect of declaration on reasonable terms and conditions (rather than access) in promoting competition in a dependent market.\textsuperscript{75}

- In 2015, the CPR agreed with the PC’s recommendation but considered the PC should have gone further and set the threshold for criterion (a) even higher.\textsuperscript{76}

- In August 2017, the Full Federal Court handed down its decision in the Port of Newcastle matter,\textsuperscript{77} affirming the interpretation of criterion (a) as decided by the Full Federal Court in the Sydney Airport matter. The Court held that the Tribunal below\textsuperscript{78} had correctly applied criterion (a) and the criterion was satisfied in circumstances where the service is a natural monopoly, the service provider exerts monopoly power and the service is a necessary input for effective competition in a dependent market with no practical or realistic commercial alternative.\textsuperscript{79} The Court acknowledged that its construction of criterion (a) lowered the hurdle from that put by the Commonwealth (represented by the NCC). To that point the NCC was of the view that ‘access (or increased access)’ in criterion (a) should be applied consistently with the interpretation given to that phrase in criterion (f) by the Full Federal Court in the Pilbara Railways matter.

- In October 2017, in response to both reviews, the Federal Government passed legislation to amend the declaration criteria largely in line with the PC’s recommendation.\textsuperscript{80} As explained in the extrinsic materials,\textsuperscript{81} the intention behind the amendments to the declaration criterion (a) was to overturn its interpretation arising from the Sydney Airport matter.

\textsuperscript{74} The PC considered that while access regulation was likely to generate net benefit to the community, its use must be limited to exceptional cases, where the benefits arising from increased competition in dependent markets would likely outweigh the costs of regulated access. 


\textsuperscript{76} The CPR’s recommendation builds on the PC’s recommendation, i.e. it must also be shown that the dependent market (on which the competition effect is assessed) is nationally significant. See \textit{Competition Policy Review, Final Report}, March 2015, p. 73-74.

\textsuperscript{77} Port of Newcastle Operations Pty Ltd v Australian Competition Tribunal [2017] FCAFC 124.

\textsuperscript{78} Application by Glencore Coal Pty Ltd [2016] ACompT 6.

\textsuperscript{79} \textit{PNO v ACT}, para 89.

\textsuperscript{80} \textit{The Competition and Consumer Amendment (Competition Policy Review) Act 2017} amended the declaration criteria in Part IIIA of the CCA. These amendments took effect on 6 November 2017.

\textsuperscript{81} Explanatory Memorandum to the \textit{Competition and Consumer Amendment (Competition Policy Review) Bill 2017}; and the Australian Government’s response on the National Access Regime, 24 November 2015.
The interpretation of coverage criterion (a)

5.41 The coverage criteria have not been amended to align with the amended declaration criteria, and there is uncertainty as to whether, and when, an alignment might occur. At the present time, the authority regarding coverage criterion (a) is likely the Full Federal Court’s decision in the Sydney Airport matter and the Port of Newcastle matters. As such, the introduction of Part 23 is unlikely to raise the issues mentioned in the last two bullet points on page 40 of the AEMC draft report.

5.42 However, the NCC acknowledges that if an alignment is to occur in the future, the type of analysis alluded to on page 40 the AEMC draft report would be required (i.e. the comparison would be between two future states of competition in a dependent market, one with full regulation (as a result of coverage), and the other with Part 23 (without coverage)). The threshold for the amended criterion (a) would arguably be higher compared to that for the pre-amended criterion (a), as intended by the amendment made to the declaration criterion (a).

5.43 The NCC would consider this development to be a natural consequence flowing from the introduction of Part 23. As noted above, Part 23 is now near ubiquitous, effectively subjecting the vast majority of pipelines in Australia to a level of obligations similar to that under light regulation. The NCC would caution against any move to further impose full regulation across the board, without valid reasons, as that may have a significant, unintended detrimental impact on investment incentives. Unless it could be demonstrated that there is significant market failure that is not able to be remedied by Part 23, and/or that there will be a material improvement in competition in a dependent market as a result of coverage, there may be little utility in imposing full regulation (as the costs may outweigh the benefits).

5.44 The NCC therefore does not share the AEMC’s concern that an alignment of the coverage criterion (a) to the declaration criterion (a) would necessarily make the criterion almost impossible to satisfy. To say so would be to speculate without considering the individual circumstances of the pipelines and assessing facts on a case-by-case basis. The fact that there is a general right of access under Part 23 would not necessarily mean that criterion (a) could not be satisfied; rather, that would be taken into account in considering the current state of competition. There may be cases where the current terms and conditions of access (under Part 23) are so inadequate and ineffective in promoting competition in a dependent market, that full regulation may achieve a better outcome, i.e. impose a more effective constraint on market power and better address the inefficiencies arising from such power.

5.45 Lastly, any assessment of the coverage threshold must also take into account the effect of future amendments (if any) to the other coverage criteria – for example, coverage criteria (b) and (d)) – and their interplay with coverage criterion (a).

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82 Further elaborated on p. 42 of the AEMC draft report.
Pipelines with a 15 year no-coverage determination

5.46 The NCC encourages the AEMC to explore the issue of whether pipelines currently subject to a 15 year no-coverage determination should be automatically exempted from Part 23, instead of having to seek exemption on a case-by-case basis. The NCC considers the application of Part 23 to those pipelines may risk regulatory over-reach, and may distort investment incentives for new pipelines.\(^84\)

5.47 The 15 year no-coverage exemption for greenfields pipelines was introduced in 2006\(^85\) following concerns from the ACCC\(^86\) and the PC\(^87\) about the possible chilling effect of gas access regulation on greenfields investment. In short, this change allowed the NCC to recommend, and the relevant Minister to make, a no-coverage determination in respect of a greenfields pipeline if the pipeline does not meet the coverage criteria. The outcome intended was that if a determination is made, the pipeline could not be covered or regulated until 15 years after commissioning of the pipeline.\(^88\)

5.48 The NCC understands that at the time of developing Part 23, the GMRG had considered the idea of providing an exemption category to those pipelines. However, in the end it decided not to do that, as it considered most of these pipelines would likely be able to obtain an exemption (or a partial exemption) through the other existing exemption categories within Part 23 (e.g. not providing third party access, or being a single shipper).\(^89\)

5.49 The NCC considers that this aspect of the regulatory design should be re-examined. As these pipelines would have already been subject to an assessment against the coverage criteria by the NCC, unlike most other pipelines subject to Part 23 that have not been tested through a similar process, it is unclear why these pipelines should be subject to Part 23 in the first instance, and be exempt only when they apply for and are granted an individual exemption by the regulator (the AER or the ERA).

5.50 The cross-over between the 15 year no-coverage determination process and the Part 23 regime could also be cumbersome to navigate, not only for existing pipeline service providers but also any future service providers contemplating investment in new greenfields pipelines.

5.51 The NCC understands that by default, greenfields pipelines with a 15 year no-coverage determination are covered by Part 23, because those pipelines are captured by the definition

\(^{84}\) Though the materiality of such risks may require further assessment.

\(^{85}\) It was introduced in 2006 into the Gas Pipelines Access Law, and it continued when the NGL was introduced to replace the previous regime.


\(^{88}\) Sections 154 and 158, NGL.

of ‘non-scheme’ pipelines. On the other hand, international greenfields pipelines with a price regulation exemption\textsuperscript{90} do not fall within the definition of ‘non-scheme’ pipelines and are therefore not regulated under Part 23.

\textsuperscript{90} No price regulation exemption has been granted to date.
Attachment A – Existing form of regulation factors (for choosing between full and light regulation)

<table>
<thead>
<tr>
<th>Form of regulation factor (s16)</th>
<th>Circumstances conducive to light regulation</th>
<th>Circumstances where light regulation less likely</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) the presence and extent of any barriers to entry in a market for pipeline services</td>
<td>Barriers to entry present but are relatively low</td>
<td>Barriers to entry relatively high.</td>
</tr>
<tr>
<td>(b) presence and extent of any network externalities (that is, interdependencies) between a natural gas service provided by a service provider and any other natural gas service provided by the service provider</td>
<td>Stand alone pipeline activity, where a service provider has no other pipeline operations</td>
<td>Greater interdependence, where a service provider has other pipeline interests in the same regions as a pipeline for which light regulation is sought</td>
</tr>
<tr>
<td></td>
<td>Rights to pipeline capacity readily tradeable</td>
<td>Rights to pipeline capacity not readily traded</td>
</tr>
<tr>
<td></td>
<td>Transmission services and other end to end services generally involve less interdependence with other pipelines</td>
<td>Distribution services (especially established ones) are likely to be more interdependent with other pipeline services</td>
</tr>
<tr>
<td>(c) presence and extent of any network externalities (that is, interdependencies) between a natural gas service provided by a service provider and any other service provided by the service provider in any other market</td>
<td>Service provider has no involvement in upstream or downstream markets (at least in areas served by a pipeline for which light regulation is sought)</td>
<td>Service provider has upstream or downstream involvements in gas or other energy businesses</td>
</tr>
<tr>
<td></td>
<td>Ring fencing and other regulatory requirements effectively prevent a service provider from taking advantage of market power in upstream or downstream markets</td>
<td>Upstream or downstream involvements are in related but not ring fenced activities, or ring fencing of pipeline operations is ineffective</td>
</tr>
<tr>
<td>Form of regulation factor (s16)</td>
<td>Circumstances conducive to light regulation</td>
<td>Circumstances where light regulation less likely</td>
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<tr>
<td>(d) the extent to which any market power possessed by a service provider is, or is likely to be, mitigated by any countervailing market power possessed by a user or prospective user (countervailing market power)</td>
<td>Large or concentrated users users with by-pass opportunities High interdependence between users and service provider Users involved in pipeline services elsewhere (such users may face lesser information asymmetry given their direct knowledge and experience of pipeline operations)</td>
<td>Many small users Users have limited resources Diverse user interests (for example where users span different industries or economic sectors) Significant users have the capacity to pass through higher pipeline service costs (these users may have less incentives to expend resources to resist increases in pipeline costs) Poorly represented users</td>
</tr>
<tr>
<td>(e) the presence and extent of any substitute, and the elasticity of demand, in a market for a pipeline service in which a service provider provides that service</td>
<td>Greater substitution possibilities exist Relatively high elasticity of demand suggesting bypass or other substitution opportunities exist Transmission pipelines (demand is generally more elastic than for distribution services) Availability of large (independent) storage capacity Ability to defer gas production/expansion for significant periods</td>
<td>Lower substitution options Low elasticity Distribution pipelines (especially established distribution pipelines with a high market penetration)</td>
</tr>
<tr>
<td>(f) the presence and extent of any substitute for, and the elasticity of demand in a market for, electricity or gas (as the case may be)</td>
<td>Fuel choice available to significant proportion of users Narrower relative prices per unit energy produced from different fuel sources Use of multi fuel plant</td>
<td>Wider relative prices between fuel types Gas dependent users Other energy sources have efficiency disadvantage Dedicated gas plant</td>
</tr>
<tr>
<td>Form of regulation factor (s16)</td>
<td>Circumstances conducive to light regulation</td>
<td>Circumstances where light regulation less likely</td>
</tr>
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<tr>
<td>(g) the extent to which there is information available to a prospective user or user, and whether that information is adequate, to enable the prospective user or user to negotiate on an informed basis with a service provider for the provision of a pipeline service to them by the service provider</td>
<td>Previous regulated pipelines (a significant base of publicly available and regulator tested information will be available for use in negotiations) Historic pipeline costs available and previously exposed to public/industry scrutiny NGL information disclosure requirements operative</td>
<td>Previously unregulated pipelines NGL information requirements impeded (for example through use of related party contracting which prevents effective scrutiny of underlying costs)</td>
</tr>
</tbody>
</table>