

Mr John Pierce  
Chair  
Australian Energy Market Commission  
PO Box A2449  
SYDNEY SOUTH NSW 1235

Dear Mr  Pierce

You would be aware that the Australian Competition and Consumer Commission (ACCC) East Coast Gas Inquiry report released in April 2016 made a suite of recommendations including:


*The COAG Energy Council should ask the AEMC to review Parts 8-12 of the NGR and to make any amendments that may be required to address the concern that pipelines subject to full regulation may still be able to exercise market power to the detriment of consumers and economic efficiency. In carrying out this review, the AEMC should also consider whether any changes can be made to the dispute resolution mechanism in the NGL and NGR to make it more accessible to shippers, so that it provides a more effective constraint on the behaviour of pipeline operators.*

Energy Ministers released a consolidated response to both the AEMC Review and the ACCC Inquiry in August 2016 committing to implement a comprehensive package of reforms. In particular, the Energy Council agreed to task the AEMC to review parts 8-12 of the NGR in line with the ACCC's recommendations.

Accordingly, I am writing to you in my capacity as Chair of the Energy Council, requesting the AEMC to undertake a review into the scope of economic regulation applied to covered pipelines, as per the attached Terms of Reference. I request that the review commence no later than May 2017 and a draft report be released by February 2018, with publication of a final report by June 2018.

I encourage you to collaborate with the Gas Market Reform Group to ensure that the review considers the concurrent work on the development of the gas pipeline information disclosure and arbitration framework and the transportation capacity trading reforms.

Sincerely



The Hon Josh Frydenberg MP  
Chair  
COAG Energy Council  
May 2017

Encl.

## **TERMS OF REFERENCE**

### **Australian Energy Market Commission**

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

##### **Background**

- Under the National Gas Law (NGL), natural gas pipelines may be subject to different levels of economic regulation: Light regulation: a negotiate-arbitrate model that focusses on commercial negotiation and information disclosure, supported by a dispute resolution process.
- Full regulation: the Australian Energy Regulator (AER) approves a full access arrangement for the pipeline, which sets out the terms and conditions (including prices) for 'reference services', which under the National Gas Rules (NGR) are services that are sought by a significant part of the market. The negotiate-arbitrate model and dispute resolution framework also apply to reference and non-reference services offered by way of pipelines subject to full regulation.

The National Competition Council (NCC) may make a recommendation whether or not a pipeline should be "covered" (i.e. subject to full economic regulation) and the relevant Minister makes a decision on this recommendation.

The NCC may determine that a pipeline should be subject to full or light regulation. In forming a view as to whether a pipeline should be subject to full or light regulation, the NCC has regard to (amongst other things) the 'form of regulation factors' set out in the NGL, which are indicators of the extent of market power a pipeline service provider can exercise.

Parts 8-12 of the NGR govern the economic regulation of pipelines subject to full and light regulation:

- Part 8 sets out the requirements for pipelines subject to full regulation to provide access arrangements (and pipelines subject to light regulation to provide limited access arrangements).
- Part 9 applies to full access arrangements and sets out how prices and revenue are determined (i.e. the building block approach).
- Part 10 includes other provisions relating to access arrangements, such as extension and expansion requirements.

- Part 11 provides that the applicable access arrangement and other information must be made available to prospective pipeline users and sets out the process for parties to seek access to pipeline services.
- Part 12 sets out certain requirements for the resolution of access disputes (the process for dealing with access disputes is additionally set out in Chapter 6 of the NGL).

In April 2016, the Australian Competition & Consumer Commission (ACCC) provided the Australian Government with its report on its inquiry into the east coast gas market.<sup>1</sup> The ACCC's inquiry examined the competitiveness of wholesale gas prices and the structure of the upstream, processing, transportation, storage and marketing segments of the east coast gas industry.

The ACCC's report included a number of recommendations to the Council of Australian Governments (COAG) Energy Council (the Council) to address issues it had identified that related to the exercise of market power by gas transmission pipeline service providers, to the detriment of consumers and economic efficiency.

Of particular relevance to these terms of reference, the ACCC raised concerns that:

1. even if a pipeline is fully regulated, the service provider of that pipeline may still be able to exercise market power to the detriment of consumers and economic efficiency; and
2. the dispute resolution framework may not be providing an effective constraint on the behaviour of pipeline service providers.

Specifically, the ACCC identified the following potential issues with the current economic regulatory framework:

1. Reference services: the current definition of 'reference service' is that the service is sought by a 'significant part of the market'. As a result, some non-contestable services are not subject to regulated terms and conditions (including prices). The ACCC suggested that pipeline owners may be able to exercise market power on these services to the detriment of consumers and economic efficiency.
2. Pipeline expansions: when a pipeline that is subject to full regulation is expanded (for example, through the addition of a compressor), the additional capacity is not necessarily included within the definition of the covered pipeline and consequently not subject to economic regulation. Again, the ACCC noted that pipeline owners may,

---

<sup>1</sup> ACCC, *Inquiry into the east coast gas market*, April 2016

as a result, be able to exercise market power on these services provided by the expansion to the detriment of consumers and economic efficiency.

3. Information and dispute resolution: there may be barriers that are preventing participants from using the access dispute resolution provisions in the NGR. As a result, the ACCC commented that the threat of arbitration was unlikely to be a constraint on the behaviour of pipeline service providers.

While the ACCC identified the above potential issues with Parts 8-12 of the NGR in its report, it was not the focus of the ACCC inquiry to carry out a comprehensive assessment of Parts 8-12 of the NGR. Therefore there may be other related issues with Parts 8-12 that were not identified by the ACCC.

Energy Ministers released a consolidated response to both the AEMC Review and the ACCC Inquiry in August 2016 committing to implement a package of comprehensive reforms that address the priority areas of gas supply, market operation, gas transportation and market transparency. In particular, the Energy Council agreed to task the AEMC to review parts 8-12 of the NGR in line with the ACCC's recommendations.

In December 2016, the Council agreed to the development of an Arbitration Framework designed to address the negotiation imbalance between pipeline customers and operators by providing for binding arbitration where commercial negotiations fail.

### **Purpose**

The AEMC is requested to make recommendations on any amendments it considers necessary to Parts 8-12 of the NGR to address concerns that pipelines subject to full regulation are able to exercise market power to the detriment of economic efficiency and the long term interests of consumers.

The AEMC should also consider whether the access dispute resolution mechanism set out in the NGL and NGR should be amended to provide a more effective constraint on the exercise of market power by pipeline service providers, including making dispute resolution more accessible to shippers.

The AEMC should examine the issues identified by the ACCC in its inquiry in relation to Parts 8-12 of the NGR, as well as any other related issues identified by the AEMC, including through stakeholder consultation.

The AEMC is requested to work closely with the GMRG to ensure consistency with all future gas market reform measures and avoid duplication of efforts, particularly in relation to the development of a framework for binding arbitration.

In carrying out this review, the AEMC should have regard to the National Gas Objective, the form of regulation factors and also consider the Council’s Vision for Australia’s future gas market.

### **Scope**

The review is to focus on transmission pipelines. However, the review will need to consider the implications of any recommendations on distribution pipelines. For example, if the definition of a ‘reference service’ is changed to address an issue related to transmission pipelines, the AEMC should consider the impacts on, and suitability of that change for, distribution pipelines.

Once a decision has been made that a service is a reference service, the ‘building block’ approach in Part 9 of the NGR is used to determine regulated prices and revenue. The appropriateness or otherwise of using the building block methodology to determine regulated prices and revenue in respect of reference services are outside the scope of this review. However, it may be necessary for the AEMC to consider consequential changes to the building block methodology in Part 9 as a result of recommendations related to other chapters. For example, if changes are made to the pipeline capacity expansion provisions, the AEMC should consider any implications for the ‘new capital expenditure criteria’ in Part 9.

### **Consultation, timeframes and deliverables**

The AEMC should carry out the review through a consultative process with jurisdictions, industry members, consumer groups and energy market bodies.

The AEMC is to publish an issues paper in the first half of 2017 and draft report for consultation in early 2018, with a final report and recommendations provided to the Council by June 2018.

<b>Milestone</b>	<b>Timeframe</b>
Terms of reference received	May 2017
Issues paper for consultation	June 2017
Draft report for consultation	February 2018
Final report to COAG Energy Council	June 2018