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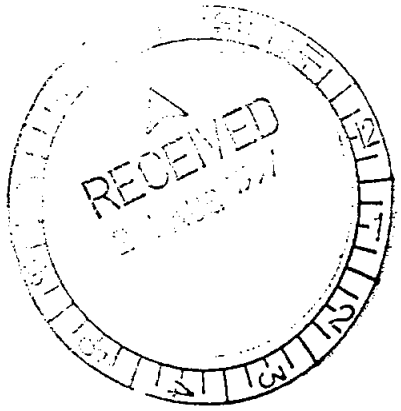

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Council
Mr Graeme

18 AUG 1997

Mr Graeme Samuel
President
National Competition Council
GPO Box 250B
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Dear Mr Samuel

Thank you for your letters dated 16 May and 18 July which enclosed the Council's recommendation on the application made by the NSW Premier for certification of the NSW access regime for natural gas distribution networks.

In considering my decision, in accordance with Section 44N of the *Trade Practices Act 1974*, I have applied the relevant principles of the Competition Principles Agreement. I am satisfied that the NSW access regime for gas distribution networks is consistent with the relevant principles of the Competition Principles Agreement, and I have decided to certify the regime as effective for the shorter of 5 years or 12 months from the date of enactment of the National Gas Pipelines Access Law by the lead legislator, South Australia.

Section 44N requires me to publish my decision, which I will do shortly. Copies of my Press Release and the Statement of Reasons for my decision are attached.

Yours sincerely

PETER COSTELLO

STATEMENT OF REASONS

DECISION

I have decided that the NSW access regime for natural gas distribution networks is to be certified as an effective access regime, for the purposes of Section 44N of the *Trade Practices Act 1974*, for the shorter of 5 years or 12 months from the date of enactment of the National Gas Pipelines Access Law by the lead legislator, South Australia.

The certification is in relation to the services of:

- natural gas distribution systems in NSW, including any extensions thereof, currently owned and/or operated by the AGL Gas Company (NSW) Limited, but excluding services connected via the ACT; and

- natural gas distribution systems in the NSW town of Albury, including any extensions thereof, currently owned and/or operated by the Albury Gas Company Limited.

In making my decision to certify the NSW access regime for natural gas distribution networks as an effective access regime, Section 44N of the *Trade Practices Act 1974* requires me, on receiving a recommendation by the National Competition Council (NCC), to apply the relevant principles of the Competition Principles Agreement and not to consider any other matters.

RELEVANT PRINCIPLES

Clause 6(2) The regime to be established by Commonwealth legislation is not intended to cover a service provided by means of a facility where the State or Territory Party in whose jurisdiction the facility is situated has in place an access regime which covers the facility and conforms to the principles set out in this clause unless:

(a) the Council determines that the regime is ineffective having regard to the influence of the facility beyond the jurisdictional boundary of the State or Territory; or

(b) substantial difficulties arise from the facility being situated in more than one jurisdiction.

I am satisfied that the NSW regime is consistent with this principle in relation to the facilities specified in Schedule A of the *NSW Gas Third Party Access Code* (the code). I note that the NCC is also satisfied in this respect.

I agree with the NCC that there was a potential for jurisdictional difficulties with the code, as originally submitted, in that more than one set of access provisions would have applied to a single service. In relation to distribution services provided by the Albury Gas Company Ltd to users on either side of the NSW-Victoria border, I am satisfied that the potential for jurisdictional difficulty has been eliminated following an amendment made by the NSW Government to Schedule A of the code which limits coverage of the code in respect of distribution services to the NSW town of Albury. In relation to distribution services provided by the AGL Gas Company to users on either side of the NSW-ACT border, I am satisfied that the potential for jurisdictional difficulty has been eliminated following an amendment made to Schedule A of the code to exclude coverage of the code in respect of distribution assets servicing Queanbeyan and Yarrowlumla Shire.

Clause 6(3) For a State or Territory access regime to conform to the principles set out in this clause, it should:

(a) apply to services provided by means of significant infrastructure facilities where:

(i) it would not be economically feasible to duplicate the facility;

(ii) access to the service is necessary in order to permit effective competition in a downstream or upstream market; and

(iii) the safe use of the facility by the person seeking access can be ensured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist.

I am satisfied that the code applies to a haulage service provided by means of a pipeline, but does not include the production, sale or purchasing of natural gas. In this respect, I consider that gas distribution networks are a significant infrastructure facility, having taken into account the following points:

- The high capital outlays and relatively low variable operating costs of gas distribution networks tend to result in significant economies of scale which act as a natural barrier to competition. This indicates that it would be uneconomical to duplicate the facilities.

- Access to the facilities will promote competition in both upstream and downstream markets. I consider that access to the facilities opens the prospect of direct negotiation between gas consumers and gas producers, and this may stimulate competition between gas producers and/or gas retailers.

- The safety considerations that are built into the code are reasonable, are not expected to impose unreasonable costs on the service providers, and provide clear guidelines for consideration by the regulator.

Clause 6(4)(a) Wherever possible third party access to a service provided by means of a facility should be on the basis of terms and conditions agreed between the owner of the facility and the person seeking access.

I agree with the NCC conclusion that the code does not preclude negotiation between the service provider and access seeker on terms and conditions. I note that the setting of access arrangements provides a minimum set of terms and conditions, but that parties are free to negotiate from that starting point.

In the case of a facility which has natural monopoly characteristics, there are potential asymmetries in the bargaining power of facility owner and access seeker. If commercial negotiation alone provided a satisfactory basis for resolving access, there would be no need for regulation. Hence, it is consistent with the Competition Principles for the access regime to provide for a minimum set of terms and conditions, without significantly impairing the ability of the parties to negotiate alternative arrangements which reflect cost and market conditions. In particular, the reference tariff does not represent a price cap and parties are free to trade off terms and conditions as best suits their requirements.

Clause 6(4)(b) Where such agreement cannot be reached, Governments should establish a right for persons to negotiate access to a service provided by means of a facility.

I am satisfied that the NSW access regime establishes a right for persons to negotiate access. I note the NCC's observation that the regime provides parties with scope to negotiate terms and conditions within a general framework which sets a basis for commercial negotiation in order to promote good outcomes. It is an appropriate balance, given the potential for asymmetry of information and market power, between commercial negotiation and regulation.

The NSW access regime does not preclude parties from pursuing any dispute resolution process that they can agree on outside the code if they believe this to be the best way of resolving a dispute but, where such agreement cannot be reached, the code also allows either party to refer the dispute to an independent arbitrator. I note that the arbitrator is not bound by the reference tariff and has sufficient flexibility to consider the particular circumstances of a dispute.

Clause 6(4)(c) Any right to negotiate access should provide for an enforcement process.

I consider that the regulator has the necessary powers to obtain the information required to resolve an access dispute and the necessary powers to enforce its determinations. I agree with the NCC recommendation that there are no material issues which may diminish these powers.

Clause 6(4)(d) Any right to negotiate access should include a date after which the right would lapse unless reviewed and subsequently extended; however, existing contractual rights and obligations should not be automatically revoked.

I agree with the NCC conclusion that the intent of this principle is to provide for a periodic review of the need for access regulation to apply to a particular service. This is sensible because, for example, technological advancements may make it economically feasible in the future to duplicate an infrastructure facility which currently is uneconomical to duplicate.

While such a review of the code is not explicitly provided for in the NSW *Gas Act* (the enabling legislation for the code), I am satisfied that the NSW access regime meets the intent of this principle. In coming to this conclusion, I have noted the NCC's reasoning that the regime provides for any party to apply at any time for revocation of coverage of the *Gas Act*, the *Gas Act* itself is subject to a review provision, and the interim nature of the NSW regime as a transition towards implementation of the National regime.

I also note that the NSW access regime does not automatically revoke existing contractual rights and obligations, although these can be revoked by the relevant Minister if, on application to the regulator by any party, the regulator recommends that such coverage should be revoked.

Clause 6(4)(e) The owner of a facility that is used to provide a service should use all reasonable endeavours to accommodate the requirements of persons seeking access.

I consider that the code is sufficient in relation to the provision of information to potential access seekers and the accommodation of specific access requests. The code adequately describes the types of information that service providers may reasonably be required to provide, and clear periods which represent a reasonable time for the service provider to respond to general information or specific access requests.

I agree with the NCC's observation, in response to an industry argument that the code goes beyond reasonable endeavours to accommodate access seekers, that it would not be appropriate to 'mark down' the NSW access regime if the code satisfies this principle more rigorously than might be expected.

Clause 6(4)(f) Access to a service for persons seeking access need not be on exactly the same terms and conditions.

I concur with the NCC's interpretation of this principle that its intent is to remove any doubt that access may be provided on different terms and conditions. In this respect, while the NSW regime provides for the setting of reference terms and conditions, these arrangements do not preclude service providers and access seekers negotiating on terms and conditions as best suits their requirements. I would expect that such commercially based negotiations may lead to a variety of access terms and conditions, and that this may occur because there are different costs and risks associated with providing access to different users.

Clause 6(4)(g) Where the owner and a person seeking access cannot agree on terms and conditions for access to the service, they should be required to appoint and fund an independent body to resolve the dispute, if they have not already done so.

I agree with the NCC's recommendation that the NSW regime satisfies this principle.

I note that the regime does not preclude parties in dispute over access terms and conditions from appointing an agreed arbitrator to resolve the dispute. If such an agreement cannot be reached, the code allows either party to refer the dispute to an independent arbitrator. The arbitrator has the discretion to order a party or parties pay some or all of its costs, as well as some or all of another party's costs.

I have noted the NCC's deliberations over the independence of the NSW Independent Pricing and Regulation Tribunal (IPART), given that IPART will act as both regulator and arbitrator under the code. I agree with the NCC's assessment that the arbitration procedures established by IPART are sufficient to allay concerns that IPART, as the arbitrator under the code, may be reluctant to publicly depart from a decision over access conditions which it had previously made as the regulator of the code. In particular, I note that:

- IPART's arbitration functions are adequately 'ring fenced' from its regulatory functions once an access dispute has been referred to it;
- adequate and transparent procedures are in place for the provision of advice, in writing only and with copies provided to the parties in dispute, between the two functions of IPART; and
- an effective independent appeals process exists through the Supreme Court of NSW under Section 44 of the *Commercial Arbitrations Act.*

Clause 6(4)(h) *The decisions of the dispute resolution body should bind the parties; however, rights of appeal under existing legislative provisions should be preserved.*

I note that the arbitrator's determinations are binding and enforceable. I also note that the code provides for Ministerial review of the arbitrator's decisions on specified grounds, and I agree with the NCC's assessment that existing appeal rights under Section 44 of the *Commercial Arbitrations Act* have not been diminished.

Clause 6(4)(i) On deciding on the terms and conditions for access, the dispute resolution body should take into account:

(i) the owner's legitimate business interests and investment in the facility;

(ii) the costs to the owner of providing access, including any costs of extending the facility but not costs associated with losses arising from increased competition in upstream or downstream markets;

(iii) the economic value to the owner of any additional investment that the person seeking access or the owner has agreed to undertake;

(iv) the interests of all persons holding contracts for use of the facility;

(v) firm and binding contractual obligations of the owner or other persons (or both) already using the facility;

(vi) the operational and technical requirements necessary for the safe and reliable operation of the facility;

(vii) the economically efficient operation of the facility; and

(viii) the benefit to the public from having competitive markets.

I note that the NSW Government has amended the code, as originally submitted to the NCC, and I agree with the NCC's recommendation that the code satisfies this principle. In doing so, I consider that an effective regime may incorporate variations to the wording of these competition principles, provided that such variations are unlikely to have a material effect on the intent of the principles, or if they relate only to reasonable transitional arrangements.

Clause 6(4)(j) The owner may be required to extend, or to permit extension of, the facility that is used to provide a service if necessary but this would be subject to:

(i) such extension being technically and economically feasible and consistent with the safe and reliable operation of the facility;

(ii) the owner's legitimate business interests in the facility being protected; and

(iii) the terms of access for the third party taking into account the costs borne by the parties for the extension and the economic benefits to the parties resulting from the extension.

I am satisfied that any requirement for a service provider to extend a facility under the code will be subject to these principles.

I agree with the NCC's interpretation of 'extend' in this principle to include the expansion of capacity and the construction of connecting mechanisms, and consider that the code is consistent with this interpretation.

I have noted industry concerns that the provision in the code that 'the service provider must not be required to extend the geographical range of a service' may conflict with this principle; however, I am satisfied that the code permits the requirement for interconnection to a facility, and therefore it allows for the geographical expansion of facilities by other parties, even if the service provider is not required to do so.

Clause 6(4)(k) If there has been a material change in circumstances, the parties should be able to apply for a revocation or modification of the access arrangement which was made at the conclusion of the dispute resolution process.

I agree with the NCC's recommendation that the NSW regime adequately provides for review in the case of material changes of circumstances.

I note that parties are permitted to determine between themselves what might constitute such material changes in circumstances, and that their commercial negotiations may include such provisions in the access contract. I also note that, where such agreed terms are not included in a contract or where other changes occur which were not included in the contract, a party may seek arbitration in the event that commercial negotiations are unable to reach agreement on the matter.

Clause 6(4)(l) The dispute resolution body should only impede the existing right of a person to use a facility where the dispute resolution body has considered whether there is a case for compensation of that person and, if appropriate, determined such compensation.

I consider that the code is consistent with this principle in that the arbitrator cannot impede the existing rights of a person to use a facility unless a case for compensation has been considered.

Clause 6(4)(m) The owner or user of a service shall not engage in conduct for the purpose of hindering access to that service by another person.

I consider that the code is consistent with this principle in that it explicitly provides that persons must not undertake any activity for the purpose of hindering access to a covered service.

Clause 6(4)(n) Separate accounting arrangements should be required for the elements of a business which are covered by the access regime.

I am satisfied that the code provides for separate accounting arrangements for activities which are covered by the code. In particular, I note that the code requires separate accounts in respect of each access undertaking, a consolidated set of accounts in respect of all of the activities undertaken by the service provider, and the allocation of shared costs according to a methodology that is 'well accepted, fair and reasonable'.

Clause 6(4)(o) The dispute resolution body, or relevant authority where provided for under specific legislation, should have access to financial statements and other accounting information pertaining to a service.

I consider that the code confers on the regulator sufficient powers to be provided with any information pertaining to a covered service, including financial statements and other accounting information, that it reasonably may require to carry out its functions.

Clause 6(4)(p) Where more than one State or Territory access regime applies to a service, those regimes should be consistent and, by means of vested jurisdiction or other cooperative legislation scheme, provide for a single process for persons to seek access to the service, a single body to resolve disputes about any aspect of access and a single forum for enforcement of access arrangements.

I am satisfied that the NSW regime is consistent with this principle. I note that the amendments made to Schedule A, as described above, will result in only one State's access regime applying to the facilities specified in Schedule A of the code.

PERIOD OF DURATION FOR THE CERTIFICATION

I note that the intention of the NSW Government is that the current access regime is a transitional regime. NSW has clearly indicated its intention to implement the National Code as soon as practicable and in accordance with the timetable agreed by all jurisdictions through the Gas Reform Implementation Group.

I believe that the period of duration for the certification balances the requirement for business certainty of participants in the NSW gas industry with recognition of the impending implementation of the National Code.

TREASURER

PRESS RELEASE

NO. 95

EMBARGO

NSW ACCESS REGIME CERTIFIED AS EFFECTIVE

I am pleased to announce that I have certified the NSW Government's access regime for natural gas distribution networks as an effective access regime pursuant to Section 44N of the *Trade Practices Act 1974* (the Act).

The NSW Government's access regime for natural gas distribution networks is the first access regime for natural gas pipelines to be certified under the new Part IIIA of the Act.

The National Competition Council (NCC) was approached by the NSW Government in October last year to assess the State access regime for natural gas distribution networks. The NCC has presented me with a report recommending that I certify the regime.

In making my decision the Act requires me, on receiving a recommendation by the NCC, to apply the relevant principles of the Competition Principles Agreement, to not consider any other matters, and to specify the period for which the decision will remain in force. I have examined the NCC report and agree with its recommendation that the NSW access regime satisfies the relevant clauses in the Competition Principles Agreement (clauses 6(2) to 6(4)).

The NSW access regime is certified as an effective access regime for the shorter of 5 years from today or 12 months from the date of enactment of the National Gas Pipelines Access Law by the lead legislator (South Australia). The duration of the regime balances the need to provide certainty for industry players while taking account of the impending introduction of nationally consistent regulation in respect of natural gas infrastructure facilities.

I note that the NCC conducted two public consultation processes as part of its examination of the regime and worked cooperatively with the NSW Government to refine the detail of the regime. I am satisfied that the consideration given by the NCC to its recommendation was careful and comprehensive.

The regime will apply to distribution networks in NSW owned by the AGL Gas Company (excluding for services connected via the ACT) and the Albury Gas Company Limited (for the city of Albury only).

I am publicly releasing my statement of reasons for certifying the NSW access regime, and I understand that the NCC will soon publicly release its recommendation. This is being done in the interests of providing guidance to policy makers in the design of future access regimes.

Benefits for Competition

The NSW regime puts in place principles and a supporting regulatory framework which encourages negotiation over terms and conditions for access to gas distribution networks. In particular, the regime provides for a right of access to gas distribution networks and, in doing so, effectively separates the businesses of gas supply, distribution and retail. This will promote competition in the NSW gas sector, with a prospective flow of price benefits to both business and household customers.

Certainty for Owners of Gas Distribution Networks

The certification of an effective access regime means that, for the pipelines covered by the NSW access regime, service providers gain some business certainty in that a prospective user can no longer seek the alternative of a declaration under Section 44H of the Act to gain access for use of that facility.

National Gas Reform

The Council of Australian Governments has agreed on a timetable for the implementation of national gas reform that will see South Australia introduce the lead legislation to enact the National Access Code for natural gas pipelines. It is expected that South Australia will introduce its legislation during October/November of this year. Other jurisdictions, including the Commonwealth, will introduce application legislation shortly after South Australia so that the national code is enacted across all jurisdictions.

Once jurisdictions have enacted the national code, each jurisdiction will apply to the NCC to have its implementation of the national code certified. It is expected that the NCC will be in a position make recommendations to me on each jurisdiction's implementation of the national code by March 1998.

CANBERRA
20 August 1997

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