(FILE) 641.3A

# The Hon Joe Hockey, MP
# MINISTER FOR FINANCIAL SERVICES AND REGULATION

The Hon John Olsen, MP
Premier of South Australia
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Dear Premier

I am writing in regard to the South Australian Government's application of 15 June 1998 to the National Competition Council (NCC) for certification of the South Australian Third Party Access Regime for Natural Gas Pipelines under the *Trade Practices Act 1974* (TPA).

On 23 September 1998, the Treasurer received the NCC's recommendation concerning the application. A copy of the NCC's recommendation is attached for your information. In accordance with Section 44N of the TPA, I have considered the NCC's recommendation and decided to certify the regime as effective.

My statement of reasons for this decision is attached.

The certification will be effective from the date of this letter and will cease to have effect after 15 years.

I have sent a copy of this letter to the Prime Minister and the Federal Minister for Industry, Science and Resources.

Yours sincerely

Joe Hockey

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# STATEMENT OF REASONS

## DECISION

I have decided to accept the National Competition Council (NCC) recommendation that the *South Australian Third Party Access Regime for Natural Gas Pipelines* (the South Australian Regime) be certified as an effective access regime, for the purposes of Section 44N of the *Trade Practices Act 1974* (TPA), for a period of 15 years.

The certification is in relation to the services provided by means of a Covered Pipeline including (without limitation) haulage services, the right to interconnect with the Covered Pipeline and services ancillary to the operation of a pipeline, but does not include the production, sale or purchase of natural gas. Schedule A of the *National Third Party Access Code for Natural Gas Pipeline Systems* (the Code) lists the pipelines which are automatically covered by the Code.

In making my decision to certify the South Australian Regime as an effective access regime, Section 44N of the TPA requires the Commonwealth Minister, on receiving a recommendation by the NCC, to apply the relevant principles of the Competition Principles Agreement and not to consider any other matters. I note that these principles are to be applied as guidelines rather than binding rules, as clarified by the recent amendment to the TPA (s44DA).

## 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 South Australian Regime is consistent with this principle in relation to the pipeline facilities specified in Schedule A of the Code. The South Australian Regime does not currently cover any cross-border pipeline systems, nor do any of the facilities in Schedule A have significant influence beyond the State's borders.

The South Australian Regime has in place processes to streamline regulation of cross-border pipelines should this become applicable. The ACCC will be the regulator of transmission pipelines and the South Australian Independent Pricing and Access Regulator (SAIPAR) will be the regulator for distribution pipelines, with a classification process to determine if a pipeline is a transmission or distribution pipeline. For distribution pipelines which cross borders, a process has been put in place to establish the jurisdictional regulator and the Relevant Minister, based on which jurisdiction has the 'closest connection' with the facility.

*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 note that all governments agreed to the inclusion of the pipelines in Schedule A, and that no submissions raised concerns in relation to their coverage or classification.

I consider that the South Australian Regime is designed to apply to gas transmission and distribution pipelines which meet sub-criteria 6(3)(a)(i)-(iii):

- The high capital outlays and relatively low variable operating costs of gas transmission and distribution networks tend to result in significant economies of scale, which act as a natural barrier to competition. This indicates that it would generally be uneconomic to duplicate the facilities (6(3)(a)(i)).
  - I note that new technologies and commercial developments may cause some existing pipelines to become economically feasible to duplicate. In this respect, I note that the Code makes provision for revocation of existing pipelines and coverage of new pipelines.
- I consider that access to the facilities opens the prospect of direct negotiation between gas consumers and gas producers, and this may stimulate competition at the production and retail levels (6(3)(a)(ii)).
- I understand that appropriate safety considerations are built into the Code (6(3)(a)(iii)).

*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 promotes an appropriate balance between commercial negotiation and regulation. It does not preclude negotiation between the service provider and access seeker on terms and conditions. I note that the regime is intended to provide a framework for commercial negotiation and is not intended to replace commercial negotiation.

*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 rights proposed in clause 6(4)(b) are provided for in the South Australian Regime. The South Australian Regime provides for voluntary or compulsory provision of access arrangements to the regulator. Regulators may accept such arrangements and, in certain circumstances, have the power to impose their own arrangements in place of compulsorily submitted arrangements. A right to negotiate access arises 14 days after the regulator's decision to approve an access arrangement comes into effect.

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

I accept the NCC's assessment that the ACCC and the SAIPAR have sufficient powers to enforce their decisions concerning access to transmission and distribution pipelines respectively. Enforcement of the regulators' decisions is provided for through Part 5 of the *Gas Pipelines Access Law* (GPAL), which provides for injunctions and damages depending on the provision breached.

*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.

The South Australian Regime does not provide for a sunset/review provision on coverage decisions as such, but it does allow a person to apply to the NCC for revocation of coverage of a pipeline at any time. Consistent with the Code, access arrangements will contain a date for review.

I also note that the ACCC and SAIPAR may not approve an access arrangement which would deprive a person of a contractual right in existence prior to the proposed arrangements being submitted, other than an exclusivity right which arose on or after 30 March 1995.

I therefore consider that the policy intent of this clause is met.

*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.*

A number of aspects of the Code as applied under the South Australian regime, such as the requirement for service providers to include a services policy in access arrangements, to keep a public register of capacity, and to meet the information disclosure provisions, all aim to accommodate the requirements of access seekers.

I agree that the provisions of the South Australian Regime strike an appropriate balance between, on the one hand, ensuring that the decisions of access seekers and regulators are adequately informed, and on the other, protecting the legitimate business interests of access providers.

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

While the South Australian Regime requires service providers to submit access arrangements which include terms and conditions, and provides for the setting of terms and conditions in the case of an arbitrated dispute, these arrangements do not preclude service providers and access seekers from negotiating terms and conditions as best suits their requirements.

I consider the requirements of this clause have been met.

*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 conclusion that the South Australian Regime is consistent with this principle.

The regime does not preclude parties from entering into commercial negotiations outside the Code. In doing so, parties can appoint an agreed arbitrator to resolve an access dispute over covered pipelines. If the Code arrangements are used, then the dispute can be referred to the independent regulator or an agent appointed by the regulator.

I note that South Australia has developed guidelines to ensure that the regulation and arbitration roles of SAIPAR are separated and that the ACCC is also preparing guidelines setting out its approach to arbitrating on disputes involving natural gas transmission pipelines covered by the National Regime. I consider that the ACCC and SAIPAR are sufficiently independent and resourced to perform these functions effectively.

*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.*

The South Australian Regime applies the Code in meeting the requirements of this clause. I note that the arbitrators' determinations are binding and enforceable under the South Australian Regime. I also note that the South Australian Regime provides for the arbitrators' decisions to be subject to appeal on a question of law under Part 4 of the GPAL and to judicial review by the Federal Court under the *Administrative Decisions (Judicial Review) Act 1977*.

I note that dispute resolution procedures commenced under the *Natural Gas Pipelines Access Act 1995* before an access arrangement is approved will continue under the Act, which contains provisions for appeal on questions of law under Section 40.

I consider the requirements of this clause have been met.

*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 investmen: 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 South Australian Regime incorporates a list of matters, consistent with clause 6(4)(i), which must be considered by the arbitrator in making a decision.

While there are a number of minor wording differences between that under the South Australian Regime and clause 6(4)(i), these do not amount to a departure from the intent of this clause and I consider that the requirements of the clause have been met.

*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 note that the South Australian Regime has applied Section 6 of the Code in addressing this clause. Section 6 requires an owner/operator of a covered pipeline to expand its capacity to meet the requirements of an access seeker, subject to certain conditions.

I note that, in its assessment of the National Regime, the NCC sought amendments to the Code to explicitly provide that the regulator may hear a dispute over the right to interconnect with another facility, and to clarify the definition of 'service' to make the right to interconnect with a covered pipeline more explicit, in order to satisfy the intent of clause 6(4)(j). Accordingly, I consider that the South Australian Regime provides for extension of a pipeline in the sense that it encompasses interconnection to a covered pipeline by a third party.

*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 note that under the South Australian regime, the arbitrator may require the service provider and prospective user to form a contract on terms and conditions of access as specified in the arbitration decision. The South Australian regime appears to allow the parties to determine what constitutes a material change in circumstances and to incorporate provisions to this effect in such a contract, including whether a material change in circumstances would require a reopening of negotiations.

While the South Australian regime does not specifically allow for revocation or modification of the access arrangement once the contract has been signed, it does not preclude review or re-negotiation in the case of material changes of circumstances. I also note that the regime does not preclude the application of common law principles (such as the doctrine of frustration) to such contracts.

*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 note that the South Australian Regime replicates that National Regime in relation to this issue. I also note that the NCC concluded that the existing right of a person to use a facility is unlikely to be impeded by the regulator and that the arbitrator cannot impede the existing rights of a person to use a facility (other than exclusivity rights arising on or after 30 March 1995).

*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 note that the South Australian Regime applies Part 3 of the Gas Pipelines Access Law (GPAL) which is in part designed to ensure that the service provider does not prevent or hinder access to a service provided by a covered pipeline.

I note that several submissions to the NCC in the context of its assessment of the National Regime expressed concerns that the Code does not provide sufficient safeguards against hoarding of capacity (which may constitute a form of hindering access). I note that provisions in Part 3 of the GPAL may help to address the issue of capacity hoarding.

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

The South Australian Regime applies Section 4 of the Code in providing for ring fencing arrangements consistent with this clause. In addition, the regulator may require the service provider to meet additional ring fencing requirements or waive any of the service providers' minimum obligations. I agree with the NCC's assessment that the South Australian Regime is consistent with this clause.

*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.*

The GPAL confers on the regulator the power to require any person to provide it with information or documents which the regulator has reason to believe will assist it in carrying out certain functions under the South Australian Regime. I consider that the South Australian Regime is consistent with this clause.

*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 South Australian Regime is consistent with this principle. The South Australian Regime includes a number of processes to streamline regulation of cross-border pipelines, including mechanisms for dispute resolution and enforcement of access arrangements. I note that the ACCC will be the regulator of all transmission pipelines and SAIPAR the regulator for distribution pipelines, and that a classification process will be in place to determine if a pipeline is a transmission or distribution pipeline. For distribution pipelines which cross borders, a process has been put in place to establish the jurisdictional regulator and the Relevant Minister, based on which jurisdiction has the 'closest connection' with the facility.

## PERIOD OF DURATION FOR THE CERTIFICATION

I have decided that the South Australian Regime be certified for a period of 15 years. I believe that the duration for the certification appropriately provides infrastructure owners/operators and users a degree of certainty in the regulatory environment, especially in the development of new infrastructure. The coverage and revocation provisions of the regime will provide the opportunity for review of its application to specific facilities within the period of certification.

Joe Hockey
Minister for Financial Services and Regulation