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National Access Regime
Productivity Commission
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Dear Commissioners

Review of the National Access Regime

Jemena is pleased to make this submission in response to the Productivity Commission's Issues Paper published in connection with its review of the National Access Regime.

Jemena owns and operates the principal gas network in NSW, one of 5 electricity distribution networks in Victoria, 2 gas transmission pipelines—the Eastern Gas Pipeline and the Queensland Gas Pipeline—and the Colongra gas transmission and storage pipeline. Jemena also has a 34 per cent interest in United Energy Distribution which distributes electricity in Victoria and a 50 per cent interest in the ActewAGL Distribution Partnership which distributes gas in the ACT and adjacent areas of NSW and electricity in the ACT. Jemena also owns and operates the distribution network for the Rosehill Recycled Water Scheme in Western Sydney.

Jemena's main interest in and experience of access is with industry-specific and jurisdictional access regimes rather than with the National Access Regime itself, and as a service provider rather than as an access seeker. That is likely to remain the case for the foreseeable future. Except for the Rosehill Scheme, all of the facilities that Jemena currently owns or has an interest in are subject to the existing national gas or electricity regimes. If someone was to seek access to the Rosehill Scheme, it would be subject to the access regime in the Water Industry Competition Act 2006 (NSW). That regime is certified under the National Access Regime.

In the remainder of this submission we respond to those of the Commission's questions where we have a view to offer.

What should be the future role for the National Access Regime

The Commission asks:

> *Is there an ongoing need for a National Access Regime? If so, what role should it play?*

The Hilmer Committee described “the ‘essential facilities’ problem” in 1993:

> Some facilities that exhibit [natural monopoly] characteristics occupy strategic positions in an industry, and are thus "essential facilities" in the sense that access to the facility is required if a business is to be able to compete effectively in upstream or downstream markets.[1]

Since then, the National Access Regime and industry-specific and jurisdictional regimes have addressed that problem effectively in key industries and for particular facilities.

In Jemena’s view the nature of the essential facilities problem remains as it was in 1993. Of course the first best solution would be for asset owners to offer and negotiate access with access seekers on a commercial basis without the need for legislated intervention. However, that is not always possible so there is a continuing role for a legal structure to cater for those cases where negotiations are unsuccessful. The National Access Regime is at the heart of that structure. It:

- defines the principles for access at a national level
- provides a standard alternative to other regimes that are uncertified or that may not satisfy the certification criteria
- provides for future instances where access to infrastructure is required and there is no alternative industry-specific or jurisdictional regime.

At the same time it is important that regimes should be able to accommodate changing circumstances. For example, it is conceivable that, with new technologies and practices, network businesses in particular will be subject to competitive forces that reduce or even eliminate their monopoly positions over time. As that occurs, lighter handed regulation or revocation is likely to be appropriate. In that context, Jemena is concerned that, under the national gas regime, a light regulation determination cannot be made in respect of a number of “declared pipelines” in South Australia, Victoria, and Western Australia. [2]

Objectives

The Commission asks:

> *Have any disadvantages emerged from having an objects clause?*
>
> *Should economic efficiency remain the primary objective of Part IIIA? Should there be other objectives? What is gained or lost by having multiple objectives, and what guidance, if any, should be given to the weightings of multiple objectives if they arise? How would this work in practice?*
>
> *Is the distinction between economic efficiency and the long-term interests of consumers important? If so, should Part IIIA and industry-specific regimes focus on economic efficiency or on the long-term interests of consumers?*

The objects clause (44AA) was an important and widely-supported addition to Part IIIA in 2006. Objectives were subsequently included in the national gas and electricity regimes albeit in somewhat different terms to those in Part IIIA. In particular the national gas objective (**NGO**) and national electricity objective (**NEO**) include “for the long term interests of consumers” as a primary evaluation criterion.

The NEO and NGO have been considered in some depth in the course of a recent review of the limited merits review regime. The Expert Panel—Professor George Yarrow, the Hon Michael Egan

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[1] Hilmer, Rayner and Taperall, *National Competition Policy*, 25 August 1993, Canberra, p. 240.
[2] National Competition Council, *A guide to the functions and powers of the National Competition Council under the National Gas Law, Part C – Light regulation of covered pipeline services*, 2010, Melbourne, para. 3.4.

and Dr John Tamblyn—that was established to inform the review process concluded that the objectives were appropriate, recommending only that:

> the words “in ways that best serve” be inserted for the word “for”, before “the long term interests of consumers” [to reinforce the intended meaning of the objectives] [3]

The Standing Committee on Energy and Resources is currently consulting on its response to the Panel’s recommendations.

The emphasis on the long term interests of consumers is appropriate for the industry-specific electricity and gas regimes which go beyond the negotiate—arbitrate model of the National Regime to provide for direct regulatory oversight over the nature and scope of services provided and the cost and pricing of those services to network users, and where there is a close connection between those services and their prices and outcomes for consumers.

At the National level the objective should remain focused on economically efficient access as a means to fostering competition in dependent markets. The connection between many of the decisions made under Part IIIA and end consumer outcomes is not nearly as clear or direct as it is for decisions in the gas and electricity regimes. Examples are declaration decisions relating to railways associated with iron ore mining for export, and certification decisions for access regimes that relate to port facilities.

It is generally held that multiple objectives create tensions that economic regulators are poorly equipped to resolve and that distributional issues and externalities, in particular, are better dealt with by Governments. Paul Kerin, CEO of the Essential Services Commission of South Australia, makes that case clearly in the lead article in a recent issue of the ACCC’s “Network” publication concluding that:

> state and territory legislators should go further and assign economic regulators a single simple objective: economic efficiency. This should replace the current primary objective ([Long Term Interests of Consumers]) and multiple subsidiary objectives or factors that regulators must have regard to.
>
> Legislators should also define the boundaries on the benefits and costs that regulators can take into account in decisions to ensure that regulators do not usurp roles better performed by others. For example, a regulator might be limited to consideration of direct benefits and costs accruing to industry participants as a result of provision of regulated services and the regulatory funding costs not directly borne by industry participants. [4]

Kerin refers to a number of authorities in support of his position including the 1993 report of the Hilmer Committee; Rod Sims, the current chairman of the ACCC; and the Productivity Commission itself:

> [regulators in the urban water sector] ... are increasingly being required to make decisions regarding the “public interest” that are properly the preserve of governments. For example, regulators often appear to be involved in decisions about whether the pricing regimes for water should be achieving income redistribution objectives In general, water pricing should be directed at efficiency outcomes, not used to achieve distributional outcomes.[5]

[3] Yarrow, Egan and Tamblyn; *Review of the Limited Merits Review Regime*; Stage Two Report, 30 September 2012, p. 38.
[4] ACCC, *Network*, Issue 43, March 2012, p, 6.
[5] Productivity Commission, *Australia’s Urban Water Sector*, Report No. 55, Final Inquiry Report, 2011, Canberra, Volume 1, p. 252.

The Commission also refers to the issue of competing objectives in its draft report on electricity network regulatory frameworks citing the Expert Panel:

> The primacy of the long term interests of customers as an evaluation criterion, set out in the NEO and the NGO, gives the conduct of regulation the same focus as that of the supply-side of an effectively competitive market (how can we improve the consumer offering?). This is admirably clear, and avoids the confusions of multiple, conflicting objectives that have had adverse effects in jurisdictions such as Great Britain. [6]

and concluding that:

> Whether such re-distributional policies should attach themselves to economic regulation depends on the desirability of such subsidies and on the relative efficiencies of the alternatives for financing them. Either way, they should not be an objective of the *competition* regulator. Budget-funded measures — such as utility allowances — have the advantage of transparency, clear parliamentary accountability and can use the same (targeted) eligibility criteria for other distributional policies to create a more coherent framework. In contrast, it can be hard to target price regulation for social welfare purposes.[7]

The Commission goes on to outline the conditions that should be satisfied where there is a decision to achieve social goals through regulatory means.

Certification

The Commission asks:

> *How effective is certification in delivering benefits from greater consistency between access regimes? What should 'consistency' mean in the context of industry-specific access regimes?*

If a regime is not certified then access seekers and service providers have the option of proceeding under Part IIIA if they consider the uncertified regime is an "inferior" alternative. In the absence of certification, and if a service has never been covered/declared, an access seeker could seek declaration under Part IIIA rather than coverage through the applicable but uncertified industry-specific or jurisdictional regime. It is also open to the owner to offer an undertaking under Part IIIA as an alternative to coverage under an uncertified regime. Even though such "forum shopping" may be unlikely, it is best avoided and certification does that.

By having Part IIIA as a fall-back for uncertified regimes, the current arrangements also accommodate the inevitable differences in the way that different jurisdictions (and industries) may choose to approach access while providing an incentive for those jurisdictional and industry regimes to at least satisfy the certification criteria.

The sorts of situations that can arise in the absence of certification are illustrated by the case of the Eastern Gas Pipeline (**EGP**). In 1999, and before the NSW access regime was certified, the owners of the EGP at the time[8] offered a voluntary undertaking under Part IIIA rather than submit to coverage and regulation under the then-current National Gas Code (**Code**). Duke adopted this approach for a number of reasons including to avoid what it saw as the "simplistic application of cost service tariffs" that would result if the pipeline was covered under the Code. The ACCC decided (in August 2000) not to accept the undertaking principally because Duke had not provided adequate information.

[6] Productivity Commission, *Electricity Network Regulatory Frameworks*, Draft Report, 2012, Canberra, Volume 1, p. 127.
[7] Ibid, p. 128.
[8] Duke Eastern Gas Pipeline Pty Ltd, DEI Eastern Gas Pipeline Pty Ltd and Duke Australia Operations Pty Ltd (**Duke**). The EGP is now owned by Jemena.

In the meantime (in January 2000), AGL Energy Sales and Marketing Limited had applied to the National Competition Council (**NCC**) for the EGP to be covered under the Code. The NCC recommended that the pipeline be covered and the Minister accepted that recommendation in October 2000. The Minister's decision was subsequently reversed on review by the Australian Competition Tribunal (**ACT**) (in May 2001) and the pipeline has remained uncovered to this day. The NSW access regime was certified in March 2001.

Pricing principles and determinations by the ACCC

The Commission asks:

> *How appropriate are the pricing principles for regulating access prices under Part IIIA? How much certainty do they provide for access seekers and service providers? When is price discrimination appropriate?*
>
> *How should access prices incorporate a return that is commensurate with the regulatory and commercial risks involved? How important is this in providing an incentive for the efficient operation of, use of, and investment in, infrastructure?*

The pricing principles in section 44ZZCA provide an essential protection to providers of declared services in that, when they are applied correctly, the service provider can expect to recover its costs, including its cost of capital. At the same time, it must be recognised that the principles provide no more than an expectation, and certainly not a guarantee, of cost recovery. Absent the protection of the pricing principles, it might be expected that owners of infrastructure that is exposed to the possibility of declaration, and potential investors in new infrastructure of national significance, will curtail investment and/or adopt other strategies that minimise the risk that an application for declaration would succeed.

Given the longevity and capital-intensive nature of infrastructure, the return (on capital) is an essential component of total cost and should be allowed for in prices in the same way as other cost components. As to the level of the return, it should be commensurate with the efficient financing costs of a benchmark efficient entity with a similar degree of risk to that of the service provider.

Efficient investment in infrastructure

The Commission asks:

> *What is the evidence that the access regime has had an effect on investment? In particular, possible 'chilling' effects, or apparent strategic responses relating to investment decisions, including infrastructure capacity, to limit competitor access? What evidence is there that efficient investment has proceeded as a consequence of access regulation?*

In the gas industry, no infrastructure owner has volunteered for coverage/regulation. On the contrary, all applications by infrastructure owners to date have been for light regulation, 15 year no coverage determinations, or revocation. There has been only one case where a gas infrastructure owner has offered a Part IIIA undertaking. As described previously, the owners of the EGP in 1999 offered an undertaking with the objective of avoiding coverage and regulation under the Code (as it was at the time). In the event the EGP was uncovered and remains so to this day. Jemena is not privy to the reasons why infrastructure owners in other industries, such as rail, may have offered undertakings under Part IIIA as opposed to negotiating access directly with access seekers or submitting to declaration.

In terms of electricity and gas, recent rule changes and current political and community sentiment have resulted in increased regulatory risk, including the likelihood of lower rates of return, the threat of ex-post capex reviews, and generally more aggressive regulation. The result will be strong incentives for service providers not to over-spend regulatory allowances, irrespective of whether those allowances are efficient. Investment in excess capacity (taking advantage of the scale economies inherent in monopoly infrastructure) is much less likely to occur in future.

All significant electricity distribution networks and transmission systems are covered by the national electricity regime or the separate regimes that operate in Western Australia and the Northern Territory. In the case of gas, a number of significant pipelines are either uncovered, have been the subject of 15 year no coverage determinations, or are covered but subject to light regulation.

Gas infrastructure owners have strong incentives to avoid coverage and full regulation which constrains commercial innovation and flexibility and introduces regulatory risks and costs. Certainly, as the owner of uncovered pipelines, Jemena's preferred position is to offer and negotiate the terms of access directly with access seekers. In our experience, the threat of declaration/coverage and all that it entails provides a real incentive to negotiate in good faith. Where gas infrastructure is subject to access regulation, it is more the case that efficient investment has occurred despite rather than because of regulation.

As noted previously, we see a continuing role for an access regime for a number of reasons including as a necessary fallback for the access seeker if negotiations are unsuccessful.

The role of review bodies and is merits review appropriate

The Commission asks:

> *Looking ahead, and in light of the High Court decision and the legislative amendments to merits reviews, will review arrangements under Part IIIA be appropriate, cost-effective, timely, fair and transparent? If so, why? If not, how could this be remedied?*
>
> *What is the rationale for merits reviews under Part IIIA? Could judicial review suffice?*
>
> *Are merits reviews of ministerial and ACCC decisions appropriate in the context of Part IIIA? Why or why not?*

Merits review has been an important component of the Part IIIA regime throughout its existence. Given the significant property rights that are at stake and the ramifications of coverage/declaration for an existing business, both financially and operationally, it is critical that correct decisions are made. Where the Minister is the decision-maker, acting on the advice of the NCC, it essential that that advice should reflect a correct interpretation and application of the law. There have been a number of instances, including the EGP case mentioned earlier, where merits review has resulted in the correction of errors. In all likelihood, those errors would have been beyond the scope of judicial review. Merits review has also clarified how the declaration/coverage criteria (in particular) are to be interpreted and applied in a way that judicial review could not have done.

The Financial Investors Group emphasises the importance of an effective merits review to investor confidence:

> Effective merits review is a fundamental protection for investors. The long term benefits for consumers from privately owned network infrastructure depends critically on confidence of investors in the economic regulatory framework, including confidence in the merits review regime.
>
> The investments that need to be made to deliver these long term benefits to consumers through capacity and service enhancement to existing networks will be affected by Government policy decisions on merits review.[9]

[9] The Financial Investors Group, *Review of the Limited Merits Review Regime in the National Electricity Law and National Gas Law, Submission on the Expert Panel's Stage Two Report*, 26 October 2012, p. 4.

While this comment is made in the context of the review of the merits review for the industry-specific electricity and gas regimes, it is equally relevant for any circumstance where decisions may affect investors' private property rights. There must be opportunities to correct decisions that are in error.

In Jemena's view, merits review has an important continuing role in the National Access Regime as it does in the industry-specific electricity and gas regimes.

If you wish to discuss this submission, please contact me on 03 8544 9053, or Warwick Tudehope on 02 9455 1551.

Yours sincerely

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