Enertrade

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Mr Michael Walsh
Director, Gas Group
Regulatory Affairs Division
Australian Competition and Consumer Commission
GPO Box 3648
Sydney NSW 2001

Dear Mr Walsh

Draft Regulatory reporting guidelines for gas pipeline service providers

Enertrade thanks the ACCC for the opportunity to comment on the ACCC's draft regulatory reporting guidelines for regulated pipelines.

Enertrade considers that, if implemented, the draft guidelines would impose unnecessary costs on businesses at a time when governments have been concerned to reduce the burden of regulation on gas supply businesses.

Please find attached Enertrade's submission outlining its concerns with the draft guidelines.

Yours sincerely

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Executive Summary

The ACCC has released draft *Regulatory reporting guidelines for gas pipeline service providers* (the guidelines) for public comment. The guidelines set out proposed requirements under section 4.2 of the *National Third Party Access Code for Natural Gas Pipeline Systems* (the Code) for the preparation of regulatory accounts for pipelines regulated under the Code (covered pipelines).

The Queensland Competition Authority (QCA) released similar draft guidelines in early 2003. The shortcomings in the Queensland draft guidelines were well identified in industry submissions made to the QCA at the time, including submissions by APIA, the AGA, Allgas, Envestra, and AGL. Enertrade commends these submissions to the ACCC as being generally indicative of the problems with the ACCC's draft guidelines.

Enertrade considers that it is premature to proceed at this stage with development of the draft guidelines, as governments are currently legislating for a change in national governance arrangements and considering their response to the Productivity Commission's review of the Gas Code.

As drafted, the guidelines exceed the legal powers of the regulator. In particular, the QCA formed the view when developing its guidelines that the regulator does not have the power to require auditing of the regulatory accounts, or to require the Board or directors to certify as to the accounts.

More generally, much of the information sought under the guidelines appears superfluous to the primary task of ensuring compliance with the ring-fencing provisions. Complying with the guidelines is likely to impose significant upfront and ongoing costs to businesses. Ironically, the amount of detail sought is actually likely to obscure rather than clarify an accurate picture of pipeline accounts. The guidelines run contrary to the clear policy signals sent by jurisdictions (through bodies such as the National Gas Pipelines Advisory Committee (NGPAC)), and the Productivity Commission that the costs of regulation are too high and should to be reduced.

Introduction

The ACCC is seeking comment on draft guidelines on the types of accounting information it requires pipeline owners to provide in respect of covered pipelines.

The scheme of the ACCC draft guidelines is that businesses owning covered pipelines regulated by the ACCC must: (i) prepare a Regulatory Accounting Manual specifying the accounting rules used in preparing regulatory accounts; (ii) have the manual approved by the regulator, and (iii) prepare annual Regulatory Financial Statements in accordance with the manual. The guidelines further propose that annual statements must be audited, approved by the Board, and signed off by the CEO and a director. The guidelines require that annual statements be disaggregated, include an asset schedule and provisions schedule, and provide a clear and well documented audit trail. Businesses must engage additional independent auditors and provide further information as required by the regulator.

Enertrade considers the guidelines will impose costs on businesses beyond the requirements of the ring-fencing provisions of the Code.

The Productivity Commission is currently reviewing the Code, chiefly due to concerns that the direct and indirect costs of regulation are impeding new investment in pipeline infrastructure. Jurisdictions have sent a clear signal that they are concerned to minimise the compliance costs of section 4. For example, the NGPAC has on a number of occasions rejected or deferred requests from regulators to expand the scope of section 4.2.[1] The NGPAC has been concerned to ensure the information gathering powers under section 4.2 do not result in the imposition of unnecessary compliance costs on business, or permit regulators to engage in unjustified “fishing” expeditions for increasing amounts of information.

Enertrade considers that, as presently proposed, the draft guidelines are:

- premature given the review of the Code and governance arrangements;
- extend beyond the legal powers conferred under section 4.1 and 4.2;
- inappropriately targeted at collecting information for general purposes rather than at ensuring businesses separate their pipeline accounts from other accounts; and
- costly, prescriptive, and inflexible, without necessarily proving a clearer picture of pipeline operations.

Enertrade expands on these concerns below.

Premature

Enertrade considers that development of reporting guidelines at this time is premature as there are a number of national reform developments impacting on the direction of the Code and governance arrangements.

First, the Productivity Commission has just completed a major review of the National Gas Access Regime, including the provisions of the Code. A key impetus of the review was to investigate and, where possible, reduce the costliness and intrusiveness of the Code, specifically including its information gathering powers (see, eg. clause 2(c) of the terms of reference).

Enertrade considers that it would be worthwhile to postpone further detailed consideration of the guidelines until after the recommendations of the Productivity Commission have become known, and the Government has developed its response. This would be consistent with the decision taken by the NGPAC, which decided at its 4 April 2003 meeting to defer proposed amendments to section 4.2 until after completion of the Commission’s review. Enertrade also understands that regulators in State and Territory jurisdictions apart from Queensland have deferred development of guidelines while awaiting the outcome of the Commission’s review.

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[1] NGPAC is the body of Commonwealth, State and Territory representatives charged with managing the Code, including considering amendments to it.

Deferring consideration of the guidelines is appropriate as the Commission's final report is likely to propose significant amendments to the Code, including to the regulatory information gathering powers.

The Commission's draft report recommended that the focus of the Code shift from cost-based regulation to high level monitoring (Productivity Commission, *Review of the Gas Access Regime: Draft Report*, December 2003). The draft report noted that the current reporting requirements are designed to support cost-based regulation, and thus are likely to be excessive in the context of more light handed monitoring arrangements (pp. 262 – 263 and 268 – 271). The Commission suggested replacing the current reporting requirements with less intrusive information gathering powers aimed at ensuring businesses are not misusing monopoly power. At a minimum, the Commission considered that the monitoring powers would "not require costs to be allocated to individual services, [thus avoiding] the need to use debatable and arbitrary assumptions on cost allocation" (p. 269).

Second, there are benefits in deferring consideration of the guidelines until the new governance arrangements are in place for gas transmission and distribution pipelines. The Australian Energy Regulator (AER) is due to assume regulatory responsibility for gas transmission pipelines from the ACCC shortly, and is likely to assume responsibility of distribution pipelines from State and Territory regulators in 2006. It would be strongly undesirable for businesses to incur the costs and inconvenience of developing reporting manuals and sets of accounts when these guidelines may be amended with a change in governance arrangements in a few years time. Enertrade considers that it would be better to wait until a single regulator is in place; this body could then develop a uniform, nationally consistent set of reporting guidelines rather than proceed at this time with the danger of creating a range of potentially inconsistent, jurisdictionally based guidelines. The Productivity Commission's draft report highlighted the importance of different jurisdictions standardising, as far as possible, their regulatory reporting requirements (p. 246) in order to lower the cost impost on businesses with pipelines in a number of jurisdictions.

Beyond legal powers

Enertrade considers that a number of measures in the draft guidelines go beyond the regulator's powers under the Code.

In particular, the draft guidelines propose that the annual accounts be:

- audited;
- approved by the Board; and
- signed off by the CEO and a director.

Just last year, the QCA acknowledged, when developing its guidelines, that the Code does not provide the regulator with legal power to require auditing or director compliance (QCA, *Decision: General Accounting Guidelines for Gas Distribution Network Service Providers*, May 2003). Thus, it is disappointing to see the same proposals being advanced again by the ACCC. Enertrade addresses the issue of the costs and benefits of auditing later in this submission.

Regulators have previously acknowledged that the regulators' legal powers under section 4.1 and 4.2 are relatively narrow, for example see IPART's submission to the NGPAC (IPART, *Maintenance and Collection of Financial and Other Data*, August 2001). The proposed guidelines sit at odds with this view.

Beyond the purposes of section four

Enertrade contends that the proposed guidelines will collect far more information than is necessary to meet the purposes of section 4 of the Code.

The broad purpose of sections 4.1 and 4.2 of the Code is provide a level of cost transparency for the operation of particular pipelines in order to confirm that appropriate ring-fencing procedures are being maintained. While section 4.2 contemplates that the regulatory reporting information collected can be used as a high level check to 'verify' the calculation of reference tariffs, this is not the primary purpose of the regulatory accounts, and there are a number of other information powers to support the determination of reference tariffs, including the information gathering powers under section 2.7, Appendix A, and section 41 of the Gas Pipelines Access Law. In its submission to NGPAC in 2001, IPART acknowledged that the chief purpose of sections 4.1 and 4.2 were to monitor ring-fencing rather than to gather information for determination of reference tariffs.

In view of the overall purpose of section 4.1 and 4.2, the draft guidelines propose excessive reporting requirements to achieve the basic purpose of the guidelines of ensuring businesses are ring-fencing pipeline accounts from accounts for other business activities.

For example, the guidelines propose annual reporting of regulatory accounts. This is not necessary to verify ring-fencing compliance. Indeed, to date, the ACCC and most other regulators have only required that businesses certify that they have complied with the ring-fencing requirements (Queensland is the only jurisdiction to date to develop and publish regulatory reporting guidelines). Enertrade considers that annual reporting is excessive in terms of assisting the regulator to determine if businesses are properly ring-fencing their pipeline operations from other operations. Further, annual reporting can only provide high level assistance in verifying the calculation of reference tariffs, as such tariffs are typically set every five years, with annual price paths based on forward projections of a number of parameters (such as expected growth, inflation). Thus, annual accounts will diverge from the annual price paths as the parameters diverge from their predicted values.

Section 4.13 clarifies that the regulator can only ask for reports from businesses "at regular intervals" to verify compliance with the ring-fencing obligations in section 4, rather than every year. Accordingly, to the extent that the ACCC proceeds with regulatory reporting guidelines, Enertrade would propose that it is appropriate that the guidelines require businesses to prepare regulatory accounts for ring-fencing compliance purposes every five years, the typical length of a regulatory review period. This would enable the regulator is confirm adequate compliance with ring-fencing requirements while enabling it to perform a high level check of the ring-fenced accounts against other information gathered for the purposes of reviewing reference tariffs.

The discussion below concerning the costs of the guidelines provides other examples of where the draft guidelines extend beyond the purposes outlined in section 4.

Costly

The ACCC's draft guidelines do not appear to reflect a considered approach to the trade off of costs and benefits in collecting more information for regulatory reporting purposes.

To date, the ACCC has imposed a minimal requirement on businesses to verify that they have met their ring-fencing obligations, including the preparation of separate accounts for each set of regulated activities. The ACCC has not identified any particular problems with the current approach to suggest that it must significantly expand regulatory reporting requirements.

Enertrade notes that more extensive reporting requirements contradict the philosophy of the Code, as well as the recommendations of the CoAG Energy Market Review, and the recommendations of the Productivity Commission's draft report that the current information gathering powers of the regulators can be "costly and intrusive" (p. 253). The Productivity Commission's draft report found that regulators' proposals to the NGPAC (referred to above) to extend their information gathering powers had "the potential to add unnecessarily to [businesses'] compliance costs" (p.246), and that regulatory reporting requirements should be kept "as close to existing gas industry accounting or record keeping practices as possible" (p. 269).

Enertrade would suggest a continuation of the current approach as representing the best trade off of the benefits of additional information as against the costs of collection.

Examples of costs

The guidelines are extensive and highly prescriptive, and will result in significant costs of businesses for little or no additional benefit.

For example, businesses will be required to prepare and maintain a Regulatory Accounting Manual. This will involve significant upfront and ongoing costs. After expending considerable time to developing the manual and having it approved by the regulator, businesses will be required to put in place procedures and controls to ensure that the manual is followed, reviewed, and updated periodically. This is likely to involve considerable internal audit costs. Moreover, the guidelines will require businesses to update the manual and resubmit it to the regulator every time there are changes in internal or external circumstances, for example due to changes in:

- the requirements of the Code or guidelines;
- accounting policies or accounting standards, for example the relevant Australian or international accounting standards;
- the chart of accounts;
- disclosures or presentations to the annual statements;
- the other business activities of the business;
- cost allocations or adjustments to cost allocations;

- the structure of the pipeline or related businesses, for example, in related entities or business units which provide shared services to the covered pipeline

Businesses will find it onerous to perform this continuous updating function, particularly given many of these changes will be generated by events outside their control.

The reporting requirements go beyond what is necessary to demonstrate ring-fencing compliance. Under the draft guidelines, Regulatory Financial Statements must include:

- General Purpose Financial Statements;
- Disaggregation Statements; and
- Special Purpose (Regulatory) Financial Statements

The Code currently requires businesses to maintain a separate consolidated set of accounts in respect of the entire business of the business. However, the draft guidelines now require this to be a set of audited General Purpose Financial Statements. In situations where businesses have no legal requirement under the Corporations Act to prepare audited General Purpose Financial Accounts, this new requirement imposes a new and significant cost burden on them.

The disclosures, audit trails, record keeping and schedules required in the Disaggregation and Special Purpose (Regulatory) Financial Statements are considerable.

In situations where a covered pipeline is owned by different entities (often within the same group of companies), a duplicate set of accounting manuals, reports, schedules and audit would be required.

The requirement in the guidelines for businesses to develop significantly disaggregated accounts will also generate significant costs, without necessarily producing significant additional transparency. Disaggregation and auditing of activity-based regulatory accounts as proposed under the guidelines will be inherently problematic and contentious and as a result will be likely to be very costly without in any way being likely to provide definitive accounts. One particular problem area recognised in the earlier quote from the Productivity Commission's draft report is the difficulty in allocating shared costs. While it might be believed that there are clear and definitive accounting rules for allocating shared costs, in reality the judgments involved for internal accountants and external auditors are highly subjective. For example, AGL advised in its submission to the QCA on the proposed Queensland reporting guidelines that a study it performed in conjunction with IPART and Deloittes Consulting found that only 38 per cent of indirect non-capital costs could be allocated on a causal basis, meaning that some more or less arbitrary rule or other had to be applied to allocate the remainder of such costs (AGL, *Submission by AGL in response to QCA draft general accounting guidelines*, April 2003, p. 6). The new international accounting standards to be applied from 2005 will only exacerbate problems in the short term in arriving at consensus on the allocation of costs.

Moreover, having imposed an extensive and costly system of reporting requirements, the ACCC anticipates that this may still not help them to form a view on whether a business has met its minimum ring fencing obligations. In this situation, the ACCC may require the business to engage an independent auditor to provide additional information. This negates the original intention that compliance with the guidelines acquits the business' reporting responsibilities.

The restrictions imposed in the guidelines may impose broader economic costs on businesses. The pipeline industry is presently considering the desirability of separating construction and ownership of pipelines from the provision of day to day operational and support services for pipelines. This is likely to make good commercial sense, since the finance and project management skills for building and owning pipelines are quite distinct from the technical management, safety, and maintenance skills required to properly manage pipelines. However, the regulatory accounting procedures may tend to impede the separation of ownership and management by requiring businesses to submit a range of disaggregated accounts for each of the related entities, and due to concerns relating to regulatory treatment of the costs charged by the management company.

Inflexible

Enertrade considers that the guidelines require businesses to follow highly prescriptive administrative procedures rather than focussing on the intent of accounts to disclose the true trading position of the relevant entity. Less prescription would provide businesses with the flexibility to change procedures, make adjustments, and change disclosures to more accurately reflect the underlying position of pipeline operations. Enertrade considers that the guidelines should focus less on disaggregation of costs and more on outcomes.

Conclusion

Enertrade considers that the ACCC should defer further development of regulatory reporting guidelines at this stage in view of the unfolding national reform and governance agenda. Overall, Enertrade would advocate continuation of the ACCC's current approach of requiring businesses to certify they have met ring-fencing requirements under the Code rather than insisting on annual reporting of a set of highly disaggregated, audited accounts. This strikes a reasonable trade off between the costs of collecting more information and the benefits of compliance and regulatory assurance.

If, in any event, the ACCC proceeds with the development of regulatory guidelines, Enertrade considers it would be preferable that they be developed at a higher level. This will reduce the cost burden on businesses in establishing the set of accounts, involve less administrative effort in updating the Regulatory Accounting Manual with each change in internal or external circumstances, and allow businesses greater flexibility to change accounts to best reflect the underlying operations of the pipeline businesses. Enertrade considers it would be sufficient for businesses to report every five years against these guidelines.