Australian Competition and Consumer Commission

National Competition Council

Regional development of natural gas transmission pipelines

A guide for regional areas considering alternatives for progressing the supply of natural gas

October 2002

ISBN 1 920702 14 8

Published by the Australian Competition and Consumer Commission, 10/02.

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Summary

This Australian Competition and Consumer Commission (ACCC) and National Competition Council (NCC) joint publication provides a general overview of key (economic) regulatory considerations involved in assessing new natural gas transmission pipeline projects. This guideline consolidates into one document a summary of the various regulatory agencies, their roles and the likely decision steps involved in assessing options for securing natural gas transmission pipeline supplies.

Regulation is not automatic in the case of gas pipeline infrastructure and indeed some pipelines are not regulated at all. To determine whether a prospective pipeline falls within the regulatory framework a number of tests must be satisfied. However, in some cases where the tests are not satisfied, a pipeline may be volunteered to be regulated anyway. In such a situation the proponent of a new pipeline proposal may consider that regulation provides an increased level of certainty in relation to the treatment of a range of investment critical factors associated with such projects.

The issues facing a pipeline project to a number of rural communities—given the greater distances and reduced population densities—may be substantially different to that of an urban development. Depending on the project-specific issues the commercial viability of such proposals will perhaps be marginal at best, regardless of whether or not it is regulated. This decision, however, is ultimately dependant on the commercial judgment of the parties involved, taking into account its efficient scale and viability.

Quite clearly, uneconomic projects are unlikely to proceed. However, where a project may be considered marginal only in the near term, the regulatory framework provides some flexibility to facilitate what is otherwise a viable proposition. Accordingly, the responsibility rests with prospective pipeline developers to tailor the optimal pipeline configuration and, if regulated, proposed access arrangement that best meets the specific requirements of a particular proposal.

This guideline will assist those parties seeking to develop natural gas transmission pipelines in their regions by:

- setting out the options—both regulated and unregulated—for progressing natural gas pipelines
- clarifying the circumstances under which a natural gas transmission pipeline is likely to be regulated
- identifying what the regulatory alternatives are for developing new natural gas transmission pipelines
- addressing a number of commonly asked questions and issues faced by regional areas interested in extending natural gas supplies.

A more detailed discussion of the technical issues associated with the regulatory and legislative framework is provided in the latter part of this guide, along with a list of relevant contacts.

While this publication explores issues relevant to pipeline infrastructure projects to rural communities, it is by no means definitive. Each proposal will require specific consideration that takes account of its unique characteristics. Therefore, early consultation by project proponents with the relevant regulatory agencies is encouraged.

1. Introduction

This document has been produced in response to the increasing interest of local government authorities in projects for the supply of natural gas to regional communities.

Natural gas is an important input to many Australian businesses and offers an economic alternative to electricity for household heating. The potential economic and social benefits of natural gas have prompted a number of local government authorities and other interested parties in regional Australia to encourage and facilitate the development of gas transmission and distribution pipelines to supply natural gas to some regional areas. The promotion and development of new pipelines may be carried out in a number of ways—and in some cases there may be regulatory implications.

The Australian Competition and Consumer Commission (ACCC) and the National Competition Council (NCC) recognise the need for local governments and interested parties to consider whether a prospective pipeline development is likely to be subject to the regulatory requirements under either the *National Third Party Access Code for Natural Gas Pipeline Systems* (the code)[1] or Part IIIA of the *Trade Practices Act 1974*. A description of the ACCC and NCC roles can be found in section 6 of this document.

This guideline sets out the range of possibilities that may apply to a proposed pipeline project from a regulatory perspective. As every project has unique characteristics that require specific consideration, it provides only a general overview to help interested parties identify the key issues and decision points regarding regulatory issues.

Prospective investors and regional councils are encouraged to consult with the ACCC and NCC at an early stage to discuss any new pipeline developments and identify whether there may be regulatory implications. Contact details for both agencies are at attachment 1 of this document.

When are pipelines regulated?

It is widely accepted that vigorous and effective competition normally provides the best means of promoting economic efficiency, a competitive economy and the welfare of consumers. In some markets, however, competition may not be possible. This has often been the case in some segments of the gas industry. Transmission and distribution pipelines often face limited direct competition because of significant economies of scale and high barriers to entry. That is, they exhibit natural monopoly characteristics. In recognition of the natural monopoly characteristics of some gas pipelines, regulation has been introduced to ensure that pipeline owners provide access to their facilities on reasonable terms and conditions.

However, in the case of gas infrastructure, regulation is not automatic because in some cases regulation may not be necessary to ensure the effective functioning and development of natural gas markets. A number of tests must be satisfied before a prospective pipeline falls within the regulatory framework. It is the NCC's responsibility to apply these tests and make recommendations to the relevant minister in response to applications for coverage (regulation) of gas pipelines under the code and declaration of infrastructure services under Part IIIA of the Trade Practices Act.

Although a pipeline may be initially regulated, interested parties have the opportunity to submit an application to the NCC to assess whether regulation should continue. Section 1.9 of the code sets out the four criteria that form the basis of this assessment. Where one or more criteria are not met the NCC will make a recommendation that coverage (regulation) should be revoked. This will then be conveyed to the relevant minister who will make a decision. More detail on this process and the number of approvals granted is provided in section 8 'Unregulated pipelines'.

Once the NCC has determined that a pipeline be covered, the transmission pipeline owner or service provider must submit an access arrangement to the ACCC for assessment.[2] An access arrangement establishes the terms and

1 Copies of the *National Third Party Access Code for Natural Gas Pipeline Systems* (the code), which is schedule 2 to the *Gas Pipelines Access (South Australia) Act 1997*, can be obtained from <http://www.coderegistrar.sa.gov.au>.

2 Gas distribution pipelines are regulated by the relevant regulatory bodies in each state (with the exception of NT).

conditions of access, including price, under which third parties may purchase access or capacity on the pipeline.[3] The ACCC's role includes assessing the implications of the regulatory decision-making process on investment in both the regulated sector and downstream markets. If regulated tariffs are set too high it may stimulate investment in regulated services but at a cost to downstream investment. The reverse applies if regulated tariffs are set too low. Note that terms freely negotiated by parties that are outside those in an access arrangement are not affected by the regulatory process (other than exclusivity provisions).

The ACCC's regulatory role is limited to natural gas transmission pipelines and does not include liquefied petroleum gas (LPG). Any queries regarding this document or other natural gas related queries should be addressed to the ACCC's email address <gas@accc.gov.au>.

2. What are the options?

The diagram in flow chart 1 (next page) broadly depicts the options available when considering how to progress the supply of a natural gas pipeline. Essentially there are three possibilities when considering a greenfields transmission pipeline project:

- the pipeline becomes 'covered' via a competitive tender or the voluntary submission of an access arrangement under the code, or
- an access undertaking in relation to the pipeline is submitted by the service provider under Part IIIA of the Trade Practices Act, or
- the pipeline is unregulated, i.e. development outside the regulatory framework. The pipeline operator, on the basis of its own commercial assessment, does not seek coverage of the proposed pipeline under the code or submit an access undertaking under Part IIIA.

Some service providers (that is owners or operators of a pipeline) may perceive benefits in securing certainty about the application of the regulatory framework to their particular assets at the outset. The ACCC released its *Draft greenfields guideline* to assist prospective transmission service providers to understand the regulatory options applying to new gas transmission pipelines in greater detail.[4]

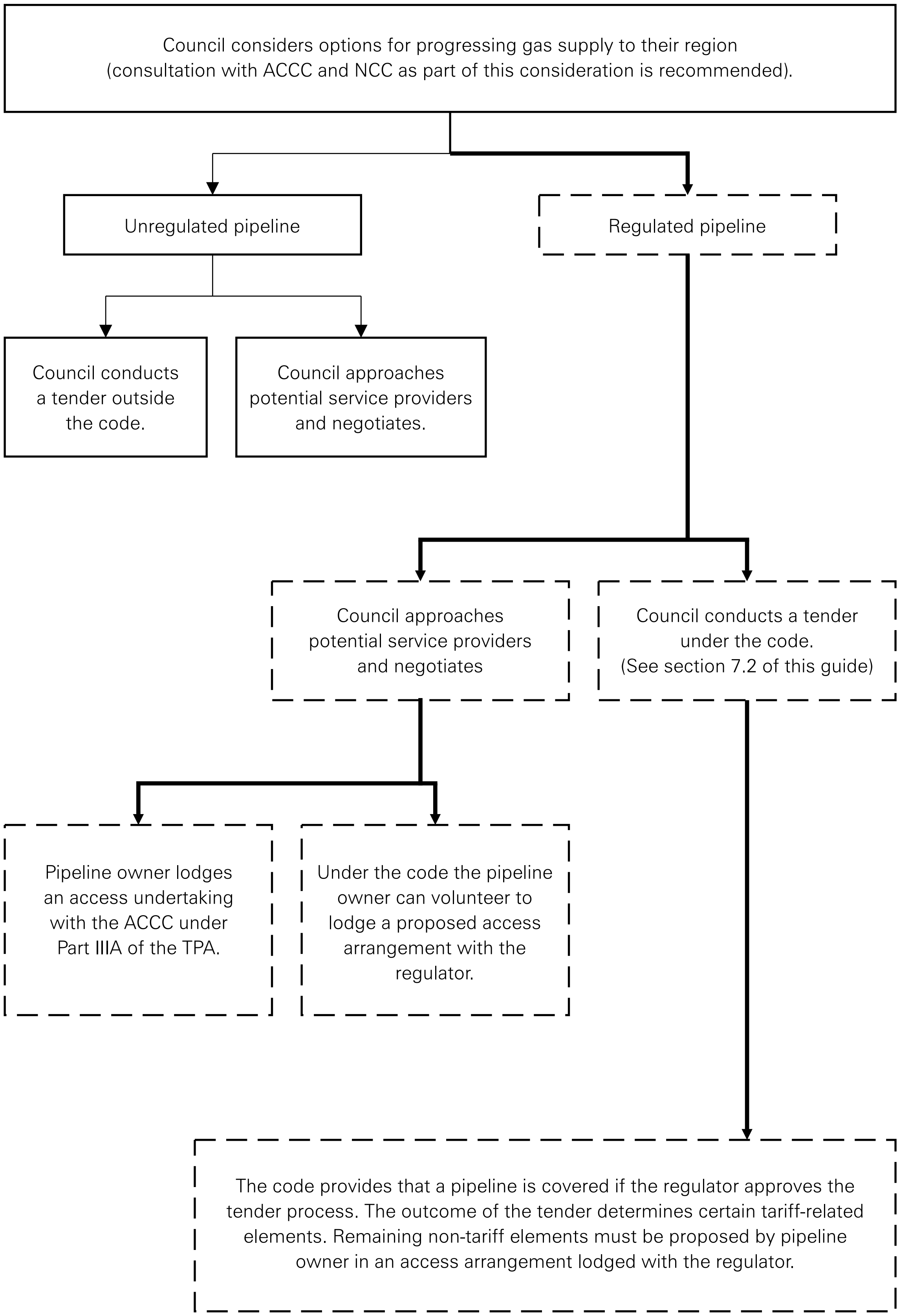
Accordingly, the ACCC's regulatory role is limited to the regulation of natural gas transmission pipelines that either:

- meet the regulatory tests and are covered under the code (or possibly the criteria for declaration under Part IIIA of the Trade Practices Act), or
- are volunteered by the pipeline owner/ operator for regulation.

[3] The ACCC does not regulate the commodity price of the natural gas transported—this is commercially negotiated with the upstream producers.

[4] ACCC, *Draft greenfields guideline for natural gas transmission pipelines—a guide to the access regulation framework for new natural gas transmission pipeline developments in Australia,* July 2002. Copies of the guideline and related consultancies are available from the ACCC's website at <http://www.accc.gov.au>.

Flow chart 1.
Options for progressing gas supply



3. The regulatory alternatives for developing new natural gas transmission pipelines

As noted in flow chart 1, if a project proponent takes the 'regulated pipeline' option there are two regulatory alternatives for pursuing a greenfields development project. Whether to conduct a tender or pursue a sole source option is likely to depend on several factors. These are not limited to but include the level of interest among prospective pipeline developers and the assessed benefits of utilising competitive tension to determine the optimal pipeline configuration and terms and conditions on which the transmission services will be provided. These can be briefly summarised as follows.

- **Option 1. A competitive tender in accordance with the code.** The competitive tendering process, if approved by the regulator, means that the transmission pipeline is automatically covered by the code. After the tender process is completed the successful tenderer is required to submit an arrangement to the regulator that sets out tariffs (that have resulted from the tender) and proposes the terms and conditions on which third parties may seek access to the services of the pipeline.

  Section 7.2 of this document provides a more detailed explanation and includes a flow chart illustration of the competitive tender process.

- **Option 2. Development outside the competitive tendering framework, but with an access arrangement or access undertaking**. The council or pipeline proponent develops the greenfields project, and on the basis of its own commercial assessment, then:

  - seeks coverage of the new transmission pipeline under the code by voluntarily extending or submitting an access arrangement under the code, or

  - submits an access undertaking under Part IIIA of the Trade Practices Act.

4. Commonly asked questions

4.1 What is an access regime and what is its purpose?

An access regime is a legal regime for the regulation of access to certain infrastructure services by third parties. An access regime will generally provide:

- a right for third parties to negotiate fair commercial terms for access to the services provided by the infrastructure subject to the regime
- a process for the determination of the terms and conditions of access—this process will usually place an emphasis on commercial negotiation by the parties but provide for arbitration in the event that negotiations fail.

The rationale for access regulation is that in some markets the introduction of effective competition requires access to facilities which exhibit natural monopoly characteristics. That is, a single facility can service at less cost than two or more facilities. For example, effective competition in natural gas exploration, production and processing and natural gas sales requires access to gas pipelines.

This may give substantial market power to infrastructure owners. Without an effective access regime this market power can be exploited by the infrastructure owner in upstream or downstream markets[5] to the detriment of consumers by:

- charging monopolistic prices to businesses using the infrastructure, or
- offering other terms of access to its affiliates at the expense of independent competitors.

Where the infrastructure owner is vertically integrated into upstream or downstream markets it may even deny access to independent competitors. Thus, the exploitation of market power by an infrastructure owner will damage competition in those upstream or downstream markets in which access to the infrastructure is essential for competition. Examples of access regimes include both:

- Part IIIA of the Trade Practices Act which establishes a national access regime for access to certain infrastructure services of national significance, such as the services provided by electricity wires, gas pipelines and rail networks, on reasonable terms and conditions
- the code and its supporting state and territory legislation which is a state and territory based national access regime for natural gas pipeline systems. The stated objective of the code is to establish a framework for third party access to gas pipelines that:
  - facilitates the development and operation of a national market for natural gas
  - prevents abuse of monopoly power
  - promotes a competitive market for natural gas in which customers may choose suppliers, including producers, retailers and traders
  - provides rights of access to natural gas pipelines on conditions that are fair and reasonable for both service providers and users
  - provides for resolution of disputes.

4.2 What is the difference between a transmission and a distribution pipeline?

When the code was first introduced in 1997 all existing pipelines were classified as either transmission or distribution. A list of these can be found in schedule A of the code.

However, pipelines built after this date have to be classified in accordance with the process outlined in the Gas Pipeline Access Law (GPAL). This process involves either the service provider, ACCC, NCC or state regulator lodging an application with the Code Registrar. This is then forwarded to the state minister in the case of a distribution pipeline, or the Commonwealth minister in the case of a transmission pipeline, for approval.

In this assessment process two aspects of a pipeline are considered, namely its function and its characteristics.

5 Upstream markets refers to markets involved in exploration and production of gas. Downstream markets refers those industries that use the gas that has been transported on the pipeline.

The function of a transmission pipeline is to transport natural gas to a region, whereas a distribution pipeline reticulates natural gas within that region. In terms of a pipeline's characteristics, consideration is given such aspects as its diameter, the pressure at which it is designed to operate, the number of points at which gas can be fed into it and the size of the area it is to serve or be served by.

4.3 What is the difference between the expansion and extension of an existing pipeline, and a new pipeline?

The expansion of a pipeline and the extension of a pipeline are separate matters and should not be confused.

- An expansion is an increase in the volume of gas a pipeline is able to carry. This can be achieved in several ways (e.g. compression, looping).
- An extension, however, is an additional length of pipeline joined to a currently regulated pipeline. As outlined below, the additional length of pipeline could be classified as either an extension of the existing network or a new pipeline.

In terms of the regulatory impact on a proposed pipeline project:

- An extension or expansion would be required to operate under the terms and conditions already set out in the network's access arrangement. This access arrangement will include a clear statement in the 'extensions and expansions policy' section as to how any significant new investment in the network will be treated. For example, it will explain whether the users of the new investment will be required to pay a tariff or a surcharge.
- In comparison, a new pipeline, if regulated, will have its own access arrangement and tariffs.

4.4 What level of returns would be allowed under the regulatory framework?

The natural gas regulatory framework requires the regulator, in making its determinations, to consider a number of objectives. These include giving a service provider the opportunity to earn revenue that recovers the costs of delivering the service over the expected life of the assets used in delivering that service, to replicate the outcome of a competitive market, to set tariffs that are efficient in level and structure, and to not distort the investment decisions in pipeline transportation systems or in upstream and downstream industries.

The evidence to date is that regulatory considerations have provided generous benchmark returns that provide clear incentives for a service provider to achieve efficiencies, grow demand for its services and outperform the benchmarked return determined for the next regulatory period.

Recent ACCC decisions relating to the gas industry have established forward looking returns on equity of around 12.68 per cent per annum. This compares favourably with returns allowed by overseas regulators and domestic stock market returns. For example, domestic stock market returns at the end of September 2002 were 4.8 per cent per annum over the past five years and 11.2 per cent per annum over the last 10 years.[6] Similarly the returns to the end of September 2002 for selected pooled funds were 2.2 per cent per annum over three years and 4.3 per cent per annum over five years.[7] However, it is important to note that care should be taken in using average market return figures as they can be very volatile.

4.5 What happens when a tender conducted under the code does not receive any conforming bids?

This is a real risk with running a tender—whether or not it is conducted under the code—and has in fact been the experience of a number of councils in recent times. A conforming tender is one that meets the minimum selection criteria requirements. However, it may be that the tender attracts expressions of interest (and not conforming bids) from potential investors. These would not meet the minimum requirements of the tender rules outlined in the tender documentation, and should this be the case the tender process would finish at this point. Councils may then wish to consider option 2 (of section 3)—i.e. directly approach and negotiate with the parties that have lodged expressions of interest.

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6 All Ordinaries Accumulation Index: 5 and 10 year moving average September 2002.

7 Mercer Investment Consulting Pooled Fund Survey for period ended 30 September 2002. See <http://www.askmercer.com.au>.

4.6 How long can an access arrangement last?

The majority of access arrangements for established pipelines have typically run for five years. But the period may be of any length, subject to the code requirement that if it is greater than five years, then the regulator is required to consider review mechanisms.[8]

A tender under the code is slightly different. In this case the code allows the regulator to consider periods of up to 15 years.[9]

A longer initial access arrangement period may also assist in providing increased regulatory certainty to the investors in new pipelines.

4.7 Will two separate tenders need to be conducted when both transmission and distribution pipelines are required to service an area?

No. It is possible to conduct one tender for the two pipelines. In the past the ACCC has demonstrated its willingness to work with state regulators to streamline the regulatory approval process and reduce the potential financial costs of conducting a tender.

In 2001 the councils of the Loddon Murray region in Victoria conducted a competitive tender under the code. The ACCC worked with the Victorian Essential Services Commission (ESC, previously the Victorian Office of the Regulator General) in assessing and subsequently approving the councils' tender approval request (TAR) to conduct the one tender for the supply of reticulated gas to the region via a transmission and distribution pipeline. In this case the ACCC and ESC recognised that given the small size of both the project and potential market, requiring two separate tenders to be conducted would potentially work against the tender attracting the number of quality bids to ensure sufficient competitive forces in the tender.

4.8 Can the outcome of a tender be determined on the basis of a 'bundled' distribution and transmission tariff?

No. The objective of unbundled tariffs is to increase transparency in the outcome (pricing) for users of the pipeline's services and this could not be achieved by a bundled tariff. The successful bidder is also required to submit an access arrangement to the respective regulators at the conclusion of the process.

However, in the case of the Loddon Murray tender the councils' TAR proposed that the successful bid be selected based on the 'average combined' transmission and distribution reference and non-reference tariffs delivered over the initial access arrangement period. While approval for this outcome would not normally be considered by regulators in larger projects, in this particular case it was considered both prudent and sensible to run one process and select the winning tender on the basis proposed, subject to tenderers specifying separate reference tariffs for the transmission and distribution components.

4.9 Do we need to employ consultants for a competitive tender process?

Conducting economic feasibility studies, provision of engineering, legal and financial advice, and the conduct and evaluation of an actual tender process itself are some of the specialist areas in which regional councils may require external input to progress a competitive tender process.

In assessing the relevant regulatory considerations to determine the best way to progress securing the supply of natural gas, regional councils are encouraged to engage in early consultation with the NCC, ACCC and relevant state regulators. The objective being to discuss the relevant issues, regional plans and options that are available to progress new pipeline developments and, importantly, whether the regulatory framework need apply at all.

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8 Refer code s. 3.18.

9 Refer code s. 3.33(d).

5. The regulatory framework

A basic understanding of the framework for the regulation of access to services provided by infrastructure facilities is necessary to assess the relevant options. This section sets out a brief summary of the regulatory framework for access to gas transmission pipelines.

5.1 Part IIIA of the Trade Practices Act

Part IIIA of the Trade Practices Act establishes a national umbrella framework for the regulation of access to the services provided by infrastructure facilities, such as gas pipelines. In essence, Part IIIA covers nationally significant infrastructure services where:

- development of competitive infrastructure would be contrary to the interests of the community as a whole because the infrastructure has natural monopoly characteristics
- access is necessary to promote competition in an upstream or downstream market—that is, access regulation would address structural impediments to competition in a market that relies on the infrastructure service as an input.

Part IIIA establishes three options for a party to seek access to an infrastructure service:

- through declaration
- by using an existing effective state/territory access regime, or
- under terms and conditions set out in a voluntary undertaking approved by the ACCC.

Declaration

Under the **declaration** pathway, a business wanting access to a particular infrastructure service applies to the NCC to have the service 'declared'. The NCC considers the application before forwarding a recommendation to the relevant Commonwealth, state or territory minister for a decision. For a facility to be declared it must satisfy the declaration criteria specified in Part IIIA of the Trade Practices Act. If a facility is declared, the business seeking access has a right to negotiate the terms and conditions of access with the facility owner. If negotiations fail, declaration also gives the business seeking access the right to have access terms and conditions determined by arbitration by the ACCC.

Effective access regimes

A facility cannot be declared if it is already the subject of an **effective state or territory access regime**. The NCC must determine whether an effective access regime is in place when considering an application to declare a service. For a state or territory regime to be assessed as an effective access regime, it must satisfy the criteria for effective access regimes set out in clause 6 of the *Competition Principles Agreement*.

The question of effectiveness can be pre-determined, through a process called 'certification'. A state or territory government may apply to the NCC for a recommendation on the effectiveness of the regime. The NCC considers the application before forwarding a recommendation to the relevant Commonwealth minister, who then decides whether or not to certify the regime as effective. Once a state or territory regime is certified as effective, access to the designated service is exclusively governed by that regime and the declaration provisions of Part IIIA are ruled out.

Access undertakings

Part IIIA allows infrastructure providers to submit a **voluntary access undertaking** to the ACCC for approval specifying the terms and conditions on which access will be made available to third parties. An undertaking may be submitted in relation to existing or proposed infrastructure.

Acceptance of an undertaking by the ACCC provides an equivalent outcome to certification—access is exclusively regulated by the terms and conditions set out in the undertaking and services covered by the undertaking are immune from declaration.

5.2 The National Third Party Access Code for Natural Gas Pipeline Systems (the code)

The code establishes a national access regime for natural gas pipelines. It sets out the rights and obligations of service providers, pipeline users and access seekers. It includes coverage rules, the operation and content of access arrangements, ring fencing arrangements, information requirements, dispute resolution and pricing principles. Under the code the ACCC is responsible for the regulation of all ‘covered’ transmission pipelines in Australia with the exception of Western Australia.[10]

Once a pipeline is covered it is subject to the principles set out in the code. The code requires individual transmission pipeline operators to submit access arrangements to the ACCC for approval, except in Western Australia.

The code is a state and territory based access regime. It gains force from complementary laws adopted by all states and territories, except Western Australia, which has a separate regime based on the code.

As at April 2002 the respective access regimes established by the code and its supporting legislation have been certified effective in all jurisdictions except Queensland (in relation to which a decision is pending) and Tasmania. Accordingly, gas pipelines covered by the code cannot be declared under Part IIIA of the Trade Practices Act.

Declaration remains an avenue for seeking access to gas pipelines that are:

- not covered by the code in South Australia, Western Australia, New South Wales, Victoria, the ACT and NT
- not the subject of an access undertaking approved by the ACCC.

However, past experience suggests that in these circumstances it is more likely that a business seeking access will make an application to the NCC for the pipeline to be covered by the code.

6. Who are the relevant regulatory bodies?

The National Competition Council

The NCC was established by all Australian governments in November 1995 to act as a policy advisory body to oversee their implementation of National Competition Policy (NCP). Part IIA of the Trade Practices Act sets out the functions of the NCC.

The NCC’s role in the regulation of gas transmission and distribution pipelines primarily includes:

- overseeing the implementation by Australian governments of NCP gas reforms designed to establish national free and fair trade in gas, in part by improving efficiency in gas transportation, through implementation of the code
- making recommendations to the relevant minister on coverage (and the revocation of coverage) of gas pipelines under the code
- making recommendations to the Commonwealth minister on certification of the state and territory access regimes established by the code and its supporting state and territory legislation.

[10] The Office of Gas Access Regulation (OffGAR) is the responsible regulator for transmission and distribution of natural gas pipelines in Western Australia.

The NCC comprises five part-time councillors with a variety of backgrounds who are drawn from different parts of Australia. It is supported by a secretariat of approximately 20 staff located in Melbourne.

The Australian Competition and Consumer Commission

Under the code, the Australian Competition and Consumer Commission (ACCC) is the designated regulator for gas transmission pipelines in all states and territories (except WA) and for transmission and distribution pipelines in the Northern Territory. It is responsible for:

- assessing proposed pipeline access arrangements and subsequent amendments
- monitoring and enforcing reference tariffs, ring-fencing, incentive regulation and other access arrangement provisions
- arbitrating access disputes between pipeline service providers and access seekers
- overseeing competitive tendering processes for new transmission pipelines
- assessing applications from industry for authorisation of anti-competitive gas supply arrangements.

The ACCC also regulates the industry through the general merger, anti-competitive conduct and consumer protection provisions of the Trade Practices Act.

The Gas Group forms part of the ACCC's Regulatory Affairs Division. The group is based in Canberra and Sydney.

State and territory regulators

The state and territory (except NT) regulators are responsible for the regulation of natural gas distribution networks, technical and licensing standards and retail price and service standards for the distribution and sale of natural gas in their respective jurisdictions.

7. Regulated pipelines

7.1 Coverage under the code

Once a pipeline becomes covered it is subject to the principles set out in the code. It should be noted at this point that there are three ways in which a greenfields or new pipeline may become covered.

1. A pipeline is automatically covered if it is subject to a competitive tendering process that has been approved by the regulator.[11]
2. A service provider or prospective service provider can volunteer that a pipeline be subject to the provisions of the code by proposing an access arrangement to the regulator for approval. Following the regulator's approval the pipeline is covered from the date that the access arrangement becomes effective until any specified expiry date (sections 1.20 and 2.3 of the code).
3. Any person may make an application to the NCC requesting that a pipeline be covered (code section 1.3). The NCC subsequently provides a recommendation to the relevant minister, who makes a decision on the matter. The criteria for determining whether a pipeline should be covered is set out in section 1.9 of the code.

Before deciding on a regulatory approach, if any, a prospective service provider has the option to seek a (non-binding) opinion from the NCC on whether a proposed pipeline would meet the criteria for coverage in section 1.9.[12]

11 Refer code section 1.21.

12 Refer code section 1.22.

Criteria for coverage

Both the NCC and the minister must consider the criteria for coverage set out in section 1.9 of the code before making a recommendation or decision, respectively, with respect to coverage of a gas pipeline. Section 1.9 of the code provides:

> Subject to sections 1.4(a) and 1.10. the NCC must recommend that the Pipeline be covered (either to the extent described, or to a greater or lesser extent than that described in the application) if the NCC is satisfied of all of the following matters, and cannot recommend that the Pipeline be Covered, to any extent, if the NCC is not satisfied of one or more of the following matters:
>
> (a) that access (or increased access) to services provided by means of the Pipeline would promote competition in at least one market (whether or not in Australia), other than the market for the services provided by means of the Pipeline;
>
> (b) that it would be uneconomic for anyone to develop another Pipeline to provide the services provided by means of the Pipeline;
>
> (c) that access or increased access to the services provided by means of the Pipeline can be provided without undue risk to human health or safety; and
>
> (d) that access (or increased access) to the services provided by means of the Pipeline would not be contrary to the public interest.

In essence, the coverage criteria limit the coverage of gas pipelines under the code (other than when the pipeline operator voluntarily subjects its pipeline to the code) to circumstances where:

- development of competitive pipelines would be contrary to the interests of the community as a whole because the gas pipeline has natural monopoly characteristics
- access is necessary to promote competition in an upstream or downstream market, e.g. the market for natural gas production and/or natural gas sales.

In addition, the coverage criteria require that:

- access be economically feasible and not be allowed to compromise the system integrity of the pipeline
- access not be contrary to the public interest; that is, the benefits of coverage should outweigh the costs.

The NCC must recommend coverage of a pipeline if it is 'affirmatively satisfied' that the pipeline meets **all** of the criteria. If the NCC is not satisfied that one or more of the criteria are met it must recommend that the pipeline not be covered.

The criteria in section 1.9 of the code were considered by the Australian Competition Tribunal (the review body for a coverage decision by the minister) in the Eastern Gas Pipeline decision.[13] The NCC has regard to the principles and reasoning established in that decision in its consideration of all coverage applications.

Based on this the NCC adopts the following process for considering the criteria.

1. Define the point-to-point gas transportation services provided by the pipeline.
2. Examine whether it is economic to develop another pipeline to provide the service (criterion (b)). A pipeline is covered only if the development of other pipelines to provide the service would be inefficient. In this sense, coverage is confined to pipelines exhibiting natural monopoly characteristics; that is, when a single pipeline can serve demand for the point-to-point transportation services at less cost than two or more pipelines.
3. If development of another pipeline to provide the service would be uneconomical, then assess whether coverage will improve the conditions or environment for competition in dependent markets (criterion (a)). For example, providing access may promote competition in upstream (gas production) and/or downstream (gas sales) markets. Whether the conditions for competition will be enhanced depends critically on whether the incumbency and technological advantage (derived from the natural monopoly characteristics of the pipeline) confer substantial market power on the pipeline operator in a dependent market. As part of this evaluation, dependent markets need to be identified, as will factors affecting the ability to exercise market power.

   In the Eastern Gas Pipeline decision, the Australian Competition Tribunal examined demand for gas in Sydney, capacity to supply that demand, likely spare capacity, the commercial imperatives facing the operator, the countervailing power of other market participants in dependent markets, and other sources of supply to dependent markets to determine whether the Eastern Gas Pipeline possessed market power.
4. Assess whether access to the service can be provided safely (criterion (c)).

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[13] Re: Application under section 38(1) of the Gas Pipelines Access Law for Review of the Decision by the Minister For Industry, Science and Resources published on 16 October 2000 to cover the Eastern Gas Pipeline pursuant to The Provisions of the National Third Party Access Code for Natural Gas Pipeline Systems and the Gas Pipelines Access Law [2001] ATPR 41,821.

5. Determine whether access would not be contrary to the public interest (criterion (d)). This criterion comes into play if the other criteria are satisfied and permits factors not raised under the other three criteria to be taken into account. For example, whether any benefits of access, such as cheaper prices and more efficient use of resources, are outweighed by regulatory or compliance costs. Other matters of public interest include environmental considerations, regional development and equity.

The NCC is currently preparing a guide to Part IIIA of the Trade Practices Act, which will include a detailed discussion of the criteria for declaration of an infrastructure service under Part IIIA. The declaration criteria are substantively similar to the coverage criteria and, accordingly, the guide will contain a discussion of the NCC's approach to interpreting the criteria for coverage under the code. The guide will be available on the NCC website at <http://www.ncc.gov.au>.

Flexibility of the code

The ACCC considers that the code has been drafted to accommodate access arrangements for prospective pipelines. The code aims to provide sufficient prescription while incorporating enough flexibility for parties to negotiate contracts within an appropriate framework. It has been designed to facilitate a national access regime which is consistent between state jurisdictions and balances the interests of investors, developers and users.

The ACCC released its *Draft greenfields guideline*[14] in July 2002 to assist prospective investors to understand whether or not pipelines need to be regulated and the flexibility and options within the existing regulatory framework.

7.2 Conducting a competitive tender

The tender process

The code provides that the regulatory framework for a new pipeline may be established through a competitive tender process. Flow chart 2 (next page) outlines the decision process.

Requirements of the council (local government authority)

The first stage of a competitive tender under the code is the consideration of a tender approval request (TAR) submitted by interested parties to the relevant regulator. Sections 3.21 to 3.28 of the code describes the process and criteria that must be addressed in such an application.

The primary objective of a TAR is to gain approval from the regulator to conduct a tender process pursuant to the code. This has the effect of determining the tariff related aspects of the proposed pipeline's access arrangement for the initial period (e.g. up to 15 years). If a tender process is carried out according to the guidelines in the code, the regulator is not required to carry out analysis of costs, returns or tariffs for the initial access arrangement period. It is anticipated that the competitive pressure between bidders for the development rights of the proposed pipeline will produce tariffs that achieve the objectives of the code.

Section 3.21 of the code states that any person may apply to the regulator requesting approval to use a tender process to determine reference tariffs and other items relevant to the determination of the reference tariffs. In most cases this 'person' is likely to be the local council/s.

Once a tender has been conducted and the outcomes approved by the regulator in accordance with the final approval request (FAR) process, the winning bidder becomes the pipeliner. Subject to the access arrangement and licensing requirements being met, the reference tariffs and terms and conditions of the winning bid become the reference tariffs and terms and conditions for the new area for the initial regulatory period. Items not determined by the tender process must be included in an access arrangement and submitted to the regulator for scrutiny in accordance with the code.

Requirements of winning bidder

The winning bidder is required to submit an access arrangement (or a revision to an existing access arrangement) to cover the new area within 90 days of the regulator approving the tender outcome. This access arrangement will include tariffs, terms and conditions determined by the tender process as well as those items not determined by the tender process. The arrangement will be subject to full public review before the regulator decides whether or not to approve it.

The winning bidder must also submit an application for a gas licence (or a variation to an existing licence) to the appropriate state or territory body.

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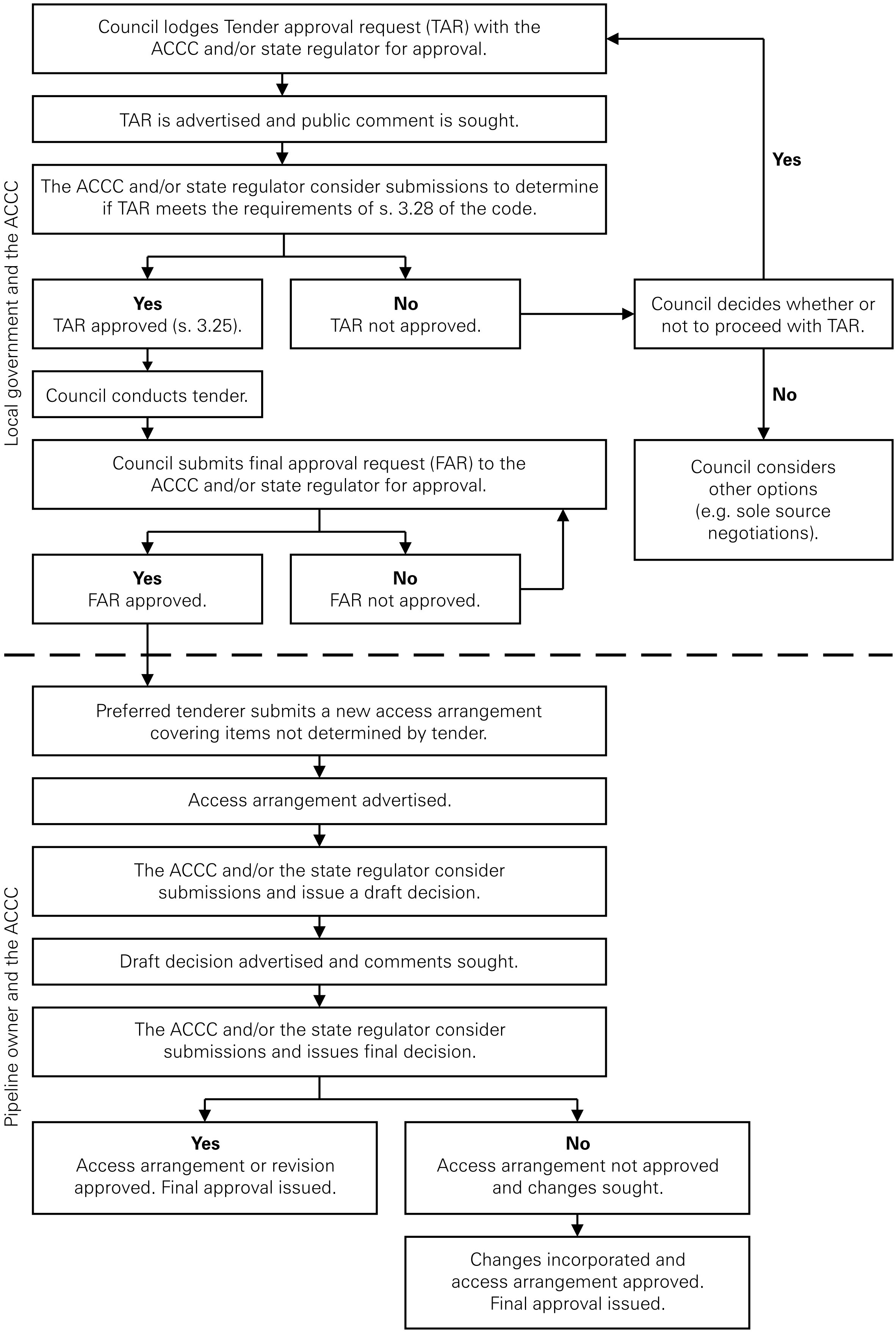
[14] ACCC, *Draft greenfields guideline for natural gas transmission pipelines—a guide to the access regulation framework for new natural gas transmission pipeline developments in Australia,* July 2002. Copies of the guideline and related consultancies are available from the ACCC's website at <http://www.accc.gov.au>.

Flow chart 2.
Competitive tender process



Other considerations

The tender process required by the code may not be appropriate in all circumstances.

For example, for some pipelines the cost of tendering may outweigh any apparent benefit from testing the market. The ACCC only envisages tendering being used in cases of pipelines to new towns or areas where the forecast demand for gas is of such a scale that competitive bids will be received and the cost of the tender process will be outweighed by the benefits.

Sections 3.28(b) and (c) of the code prohibit the regulator from approving a tender process when it is not 'in the public interest' and when 'the number and character' of tenders received will not ensure a competitive outcome. The code provides no guidance on how these terms should be interpreted. But in considering any request to conduct a tender the ACCC will take into account the general level of interest in the project (of which there may be some indication if expressions of interest have been called for) as well as the number and competitiveness of tenders received in respect of new areas with similar customer numbers, load, and geographic and cost profiles.

The process

The broad process for determining reference tariffs through a tender process can be found in flow chart 2 of this document. The chart sets out the procedure for approval of an access arrangement conducted under the code through a competitive tender process.

7.3 Submission of a Part IIIA undertaking

Under Part IIIA, service providers can submit access undertakings to the ACCC specifying the terms on which access to infrastructure services, such as gas pipelines, will be made available to third parties.

For further guidance on access undertaking considerations readers are referred to the ACCC guideline, *Access undertakings*.[15]

7.4 Similarities between regimes

While the code may appear more prescriptive than Part IIIA, both are essentially based on the same principles.

Part IIIA was the basis upon which the code was developed. The intention was that an 'access arrangement would be similar in many respects to an undertaking under Part IIIA'.[16] Further, the code was specifically designed to address access to natural gas pipelines. The code is a major component of access regimes that have been certified as 'effective' in a number of jurisdictions.

7.5 Potential for regulatory overlap

As noted above Part IIIA provides for existing access regimes, such as the code, to be recognised as 'effective' by the relevant minister (on recommendation from the NCC). The services covered by jurisdictional gas access regimes that have been recognised as 'effective' under Part IIIA of the Trade Practices Act cannot subsequently be declared under Part IIIA.

Part IIIA does not explicitly state that certification of an access regime as 'effective' also excludes the acceptance of an undertaking by the ACCC. However, Part IIIA does require that in assessing undertakings the ACCC will have regard to whether access to the service is already the subject of an access regime. Accordingly, the ACCC will establish whether there is an existing access regime and if so consider whether an undertaking is necessary.[17]

15 ACCC, *Access undertakings—a guide to Part IIIA of the Trade Practices Act*, September 1999.

16 *National Third Party Access Code for Natural Gas Pipeline Systems*, November 1997, p. 1.

17 ACCC, *Access undertakings—a guide to Part IIIA of the Trade Practices Act*, September 1999, pp. 15, 16.

8.
Unregulated pipelines

On the basis of its own commercial judgment a prospective service provider may also elect to build an unregulated pipeline, with or without consultation with regulatory authorities. A typical example of where this would be the case is when the prospective service provider considers that the pipeline would fail to meet at least one of the tests for coverage or declaration under the code or under Part IIIA, respectively.

Prospective service providers are encouraged to consult with the NCC (on whether a proposed pipeline is likely to meet the criteria for coverage in accordance with section 1.9 of the code)[18] and the ACCC, when considering the optimal regulatory approach.

It is important to note that a service provider's election not to provide a voluntary access arrangement or access undertaking does not preclude a third party seeking coverage (under the code) or declaration (under Part IIIA) at some time in the future. As noted earlier, under the code any person may at any time make an application to the NCC requesting that a pipeline be covered. If, based on the NCC recommendation, the relevant minister decides that the pipeline should be covered under the code, the service provider would then be required to submit an access arrangement for the pipeline.

The code—revocation of coverage

Revocation of coverage of a pipeline under the code can be sought (ss. 1.24–1.39) by making an application to the NCC. In assessing the application the NCC must be affirmatively satisfied that the pipeline does not meet one or more of the criteria set out in section 1.9 of the code (as detailed above). The NCC's recommendation is subsequently conveyed to the relevant minister, who makes a decision on the matter.

On the commencement of the code, Schedule A listed the pipelines that were automatically to be covered by the code (s. 1.1). Of approximately 47 regulated pipelines in Australia listed in Schedule A and automatically covered by the code, 16 revocations of coverage have been approved in the last four years with one further revocation application pending in NSW. In respect to these pipelines, the application for revocation presented the first opportunity for assessment of the pipeline against the coverage criteria set out in the code.

Some examples of the reasons for the revocation of pipelines include the following.

- Coverage of the Parmelia pipeline in Western Australia was revoked by the relevant minister in March 2002. The NCC recommended, and the minister agreed, that the pipeline did not satisfy criteria (a), (b) and (d). With regard to criterion (a), the pipeline does not have sufficient market power to hinder competition in the upstream and downstream markets. Furthermore, there is significant unused capacity on the Parmelia pipeline. Gas consumers in the south-west of Western Australia also have a choice of either Perth Basin gas transported via the Parmelia pipeline or the Dampier to Bunbury pipeline (DBNGP), and Carnarvon Basin gas can also be transported via the Dampier to Bunbury pipeline. The minister also took into consideration the service provider's undertaking to honour current regulated tariffs. With regard to criterion (b), the NCC concluded, and the minister agreed, that the DBNGP may be able to provide the services provided by the Parmelia pipeline. A technical analysis of the ability to economically develop the DBNGP suggested to the NCC, and to the minister, that it is a credible possibility to economically develop the DBNGP to provide the services provided by the Parmelia pipeline.
- Coverage of the Riverland and Mildura pipelines was revoked by the relevant minister in September 2001. The NCC recommended, and the minister agreed, that the pipeline did not meet criteria (a) and (d). The NCC had not received any indication that any retailer had sought, or was likely to seek, access to the pipeline and, equally, no customer had indicated that it had sought access to the pipeline for the purpose of purchasing gas. Furthermore, the NCC was satisfied that there was excess capacity and the pipeline faced incentive to expedite access.
- Coverage of the Palm Valley to Alice Springs pipeline was revoked in July 2000. The NCC was not satisfied that coverage would

18 Refer code section 1.22.

promote competition in the upstream market because the current producers in the Amadeus Basin (source of gas for the pipeline) were the only likely suppliers of gas into the pipeline and had long-term contracts. Furthermore, the NCC was not satisfied that coverage would promote competition in the downstream market for gas sales and electricity generation (gas-fuelled electricity). The pipeline has one customer who was under contract for its current needs until 2008. In the meantime, regulated access would bring no competitive benefit to the customer (and its customers) unless they could grow the market to ship gas above and beyond their current contractual arrangements, which appeared unlikely.

The NCC treats each application for coverage or revocation on its merits. Where pipelines possess similar characteristics, then it could be expected that consistent application of the coverage criteria would result in the same coverage or revocation outcome in respect of each pipeline. However, where there are significant differences between pipelines, a consistent application of the coverage criteria might mean different coverage outcomes.

ATTACHMENT 1

Where to get more information

National bodies

Code Registrar

The functions of the Code Registrar are purely administrative.

Copies of the National Third Party Access Code for Natural Gas Pipeline Systems (the code), which is schedule 2 to the *Gas Pipelines Access (South Australia) Act 1997*, can be obtained from <http://www.coderegistrar.sa.gov.au> or by phoning (08) 8226 5786.

National Competition Council

The National Competition Council (NCC) was established by all Australian governments in November 1995 to act as a policy advisory body to oversee their implementation of National Competition Policy (NCP). The NCC's role in the regulation of gas transmission pipelines includes:

- overseeing the implementation by all Australian governments of NCP gas reforms designed to establish national free and fair trade in gas
- making recommendations to the relevant minister on coverage (and the revocation of coverage) of gas pipelines under the code
- making recommendations to the Commonwealth minister on certification of the state and territory access regimes established by the code and its supporting state and territory legislation.

More information on the NCC can be found at <http://www.ncc.gov.au> or by phoning (03) 9285 7474.

Australian Competition and Consumer Commission

The Australian Competition and Consumer Commission (ACCC) is the designated regulator for gas transmission pipelines in all states and territories (except WA) and for transmission and distribution pipelines in the Northern Territory.

The ACCC website can be found at <http://www.accc.gov.au>.

Natural gas regulation queries can be directed to email address <gas@accc.gov.au> or by phoning (02) 6243 1111.

State regulators

Queensland

The Queensland Competition Authority (QCA) is an independent statutory authority consisting of members appointed by the Governor in Council. More information on QCA can be found at website <http://www.qca.org.au> or by phoning (07) 3222 0555.

New South Wales

The Independent Pricing and Regulatory Tribunal (IPART) is responsible for the regulation of the water, gas, electricity and public transport industries in New South Wales. More information on IPART can be found at <http://www.ipart.nsw.gov.au> or by phoning (02) 9290 8400.

ACT

The Independent Competition and Regulatory Commission (ICRC) is a statutory body set up to regulate prices, access and other matters in relation to regulated industries and to investigate competitive neutrality complaints and government-regulated activities. The website can be found at <http://www.icrc.act.gov.au>.

Victoria

The Essential Services Commission (ESC) is the independent economic regulator established by the State Government of Victoria to regulate prescribed essential utility services supplied by the electricity, gas, water, ports, grain handling and rail freight industries.[19] More information on ESC can be found at <http://www.esc.vic.gov.au> or by phoning (03) 9651 0222.

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[19] In particular refer to the guideline *Gas Industry Guideline No. 2: Provision of Gas to Areas not Serviced by an Existing Distributor* [Issue No. 3] (updated on 31 May 2001).

Tasmania

The Office of the Tasmanian Energy Regulator (OTTER) is responsible for the regulation of the gas and electricity supply industries in Tasmania. More information on OTTER can be found at <http://www.energyregulator.tas.gov.au> or by phoning (03) 6233 6323.

South Australia

The South Australian Independent Pricing and Access Regulator (SAIPAR) was established in May 1998 under the *Gas Pipelines Access (South Australia) Act 1997* to administer the regulatory framework in accordance with the ‘national code’. More information can be found at SAIPAR’s website <http://www.saipar.sa.gov.au> or by phoning (08) 8226 5788.

Western Australia

The Office of Gas Access Regulation (OffGAR) was established on 23 February 1999 and supports an Independent Gas Access Regulator who is responsible for the regulation of access to both gas transmission and distribution pipelines located within the boundaries of the state. More information on OffGAR can be found at <http://www.offgar.wa.gov.au> or by phoning (08) 9213 1900.

Northern Territory

The ACCC is the designated regulator for natural gas transmission and distribution pipelines in the Northern Territory.

The Utilities Commission of the Northern Territory is the independent industry regulator, established to oversee those industries declared to be regulated industries. More information about the Utilities Commission can be found at <http://www.utilicom.nt.gov.au> or by phoning (08) 8999 4580.

ATTACHMENT 2

Glossary of industry terms

Access arrangement	Arrangement by owner or operator of a covered pipeline setting out the terms and conditions and tariffs on which third parties may seek access to the services of the pipeline. Access arrangements must be approved by the relevant regulator as complying with the requirements of the national code.
Code	National Third Party Access Code for Natural Gas Pipeline Systems. The code is part of the GPAL (Gas Pipeline Access Law) and is set out in Schedule 2 to the *Gas Pipelines Access (South Australia) Act 1997*.
ACCC	Australian Competition and Consumer Commission.
Covered pipeline	Pipeline to which the provisions of the code apply.
FAR	Final approval request has the meaning given in section 3.29 of the code.
Fixed principle	An element of the reference tariff policy that can not be changed by the regulator without the agreement of the service provider. It may be any **structural element** but not **market variable element** of the reference tariff policy. The code allows for tender rules and procedures to stipulate that certain tender outcomes will be fixed for a specific period and not subject to change when a service provider submits for a review of an access arrangement.
Fixed period	Period during which the **fixed principle** may not be changed. A fixed period may be for part or all of an access arrangement.
GJ	Gigajoule, a unit of measurement for measuring the energy content of natural gas or other energy sources.
GPAL	Gas Pipeline Access Law, which in conjunction with the national code and the Gas Access Acts, sets out provisions of the regime for third party access to the services of gas pipelines. The GPAL is set out in schedules 1 and 2 to the *Gas Pipelines Access (South Australia) Act 1997*.
Market variable element	Means a factor that has a value assumed in the calculation of a reference tariff, where the value of that factor will vary with changing market conditions during the access arrangement period or in future access arrangement periods. This can include sales or forecast sales, any index used to estimate the general price level, real interest rates, non-capital costs and any cost on the nature of capital costs.
MDQ	Maximum daily quantity.
NCC	National Competition Council.
Pipeline	Has the meaning given in the Gas Pipeline Access Law (GPAL).
PJ	Petajoule (equal to 1 000 000 GJ).
Reference tariff	Means a tariff specified in an access arrangement as corresponding to a reference service and which has the operation as described in sections 6.13 and 6.18 of the code.
Ring fencing	Restricting flows of information and personnel within an integrated utility, and between related businesses.

Service provider	In relation to a regulated pipeline or proposed pipeline a service provider is the person or entity that is to be the owner or operator of the whole or any part of the pipeline.
TAR	Tender approval request has the meaning given in section 3.21 of the code.
TJ	Terajoule (equal to 1 000 GJ).
Undertaking	A form of voluntary regulation providing for access to a service. Undertakings are provided for under Part IIIA of the Trade Practices Act and must be approved by the ACCC.
Upstream and downstream markets	In a production chain, upstream markets are markets for the inputs required to produce a good or service; downstream markets are the markets which use that good or service as inputs to produce a more value-added good or service. In the gas supply industry, gas exploration, production and processing are ‘upstream’ industries and retail supply is ‘downstream’.
Vertical integration	Bringing successive stages in production and marketing under the control of one organisation, e.g. combining gas exploration, production, and processing, transmission, distribution and retailing.
WACC	Weighted average cost of capital.