Overview of gas reforms

Allan Asher
Deputy Chairman
Dept of Tresury and Finance
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1. Introduction

The Gas Reform Implementation Group has advised the Commission that it is considering which Part IIIA approval process for the draft national Gas Access Code should be adopted to avoid the risk of Part IIIA declaration of pipelines to be regulated by the Code. Specifically, it is considering whether the "effective access regime" or the "industry access code/undertakings" approval processes would provide the most certain and timely route for approval of the Code and for ongoing amendments to and administration of the Code.

In that context, the Implementation Group invited the Commission to present its views on the Code at a meeting on 26 March 1997.

As policy consideration of the access undertakings approval alternative is a very recent development, the Commission has not given detailed consideration to the acceptability of the Code in terms of the SS 44ZZA/44ZZAA criteria at this stage. It would also be inappropriate to provide unqualified comments on the Code at this time which could prejudice the Commission's more detailed formal analyses, public inquiries and decision-making should the Code be submitted to it later for approval under Part IIIA.

Nevertheless, the Commission can indicate its general views on the Code as a whole in the context of the energy sector competition and regulatory reforms. It can also provide initial observations on those aspects of the Code which appear at this stage to comply with the relevant Part IIIA criteria and those areas of the Code which are likely to require closer examination against the criteria by the Commission against the criteria.

This paper sets out the Commission's preliminary views on the Code in those terms. It also provides some initial observations on procedural and timing aspects of the Commission's industry code/undertaking approval processes.

2. Part IIIA undertakings criteria: The ACCC's approach

The Commission's assessment of the Gas Access Code and of individual access undertakings based on the Code would be subject to the legislative requirements of sections 44ZZAA and 44ZZA of the Trade Practices Act and relevant regulations.

Section 44ZZAA(3) of the Act allows the Commission to accept an industry access code submitted to it by an industry body (prescribed in regulations for the purpose) after having regard to the following matters:

(a) the legitimate business interests of providers who might give undertakings in accordance with the code;
(b) the public interest, including the public interest in having competition in markets (whether or not in Australia);
(c) the interests of persons who might want access to the services covered by the code;
(d) whether the service is already the subject of an access regime;
(e) matters specified in regulations, in particular:

(i) government legislation and policies relating to ecologically sustainable development;
(ii) social welfare and equity considerations, including community service obligations;
(iii) government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity;
(iv) economic and regional development, including employment and investment growth;
(v) the interests of consumers generally or of a class of consumers;
(vi) the competitiveness of Australian businesses;
(vii) the efficient allocation of resources; and

(f) any other matters the Commission thinks are relevant.

The Commission must not accept a code unless it has first published the code, invited public submissions on it and considered the submissions received.

Section 44ZZA allows the Commission to accept undertakings from individual service providers in relation to an access regime after having regard to matters which are virtually identical to those set out in (a), (b), (c), (d) and (f) above. The section also provides that where an undertaking is submitted in accordance with an access code which has been approved under S.44ZZAA, there is no requirement to publish the undertaking or to call for and consider submissions on it before the Commission may approve the undertaking.

Thus, the procedure for gas pipeline operators to obtain protection from Part IIIA declaration through the ACCC approval processes of SS 44ZZAA and 44ZZA would involve two inter-related steps: acceptance of the industry-wide gas access Code **and** approval of access undertakings from individual pipeline operator based on the Code. Those approvals are to be given only after the Commission has had regard to the criteria set out in the two sections which require, among other things, consideration of the interests of pipeline service providers and third parties who may require access to pipeline services and consideration of the public interest, including in having competition in markets.

In December 1996, the Commission published a draft guide to access undertakings under Part IIIA of the TPA to inform service providers and other interest groups about the relevant statutory requirements and the Commission's approach to interpreting them. The draft guide also outlines procedures for lodgement and assessment of undertakings and the public consultation processes the Commission will adopt.

In addition to the observations on the Code provided in this paper, the draft undertakings guide will be an important reference source for the Implementation Group in considering the relative merits of the alternative Part IIIA code approval processes.

3. General observations on the Gas Access Code

The Commission has been and remains a strong supporter of the general approach being taken through the draft national gas access Code to the establishment of third party rights of access to gas pipelines, where such access is necessary for the promotion of effective competition in upstream and downstream energy markets.

The general co-operative strategy being adopted by Australian Governments to promoting reform, competition and free interstate trade in the gas industry involves:

n measures to promote effective competition in those sectors of the industry where competition is feasible, namely in gas production, marketing and wholesale and retail supply; and

n measures, including the Code, to underpin that competition with efficient regulation of access to the natural monopoly transmission and distribution pipeline infrastructure that carries gas from production basins to gas markets.

The Commission considers that the unbundling of gas production and supply from gas transportation by means of the national pipeline access Code is essential to the promotion of more effective competition between existing market participants and to the entry of vigorous new gas market participants. It will also be important in promoting gas field on gas field and pipeline on pipeline competition. Specifically, the Commission believes that the effective implementation of the Code should promote the following competitive developments in the gas market:

- entry of gas marketers and aggregators promoting more competitive trading in gas and transportation rights and more flexible and efficient contracting and trading arrangements;
- direct gas and transportation purchases by large industrial companies and new entrant retailers putting competitive pressure on existing gas producers and distributor/retailers to compete more aggressively to protect their market positions;
- more efficient pricing and usage of gas transmission and distribution infrastructure and further investment in the development and interconnection of the transmission pipeline grid; and
- ultimately, more competitive pricing of gas, more efficient usage of and investment in national gas resources and further growth and development of the national gas market overall.

The Commission believes that it is important to keep these fundamental objectives of the gas market reforms in mind when discussing the more detailed aspects of the gas access code. Such discussions should also have regard to the broader community goal of the gas market and related public utility reforms which is

to ensure that the realised efficiency gains are passed on to downstream industries and to final consumers and that they provide an important stimulus to investment, employment and economic growth in the economy as a whole.

4. ACCC veiws on the code in terms of its Part IIIA role

4.1 General Assessment Against the Part IIIA Criteria

Viewed in general terms, the Code appears to stand up quite well against the criteria in S.44ZZAA for acceptance of industry access codes by the ACCC.

The objectives of the code and its main features and mechanisms are broadly directed to promoting competition in upstream and downstream markets and to preventing the abuse of monopoly power by infrastructure operators, while seeking an appropriate balance between the legitimate commercial interests of pipeline operators and the rights of third parties to access to haulage services at reasonable prices, terms and conditions.

In terms of the legitimate business interests of pipeline service providers, the Code will allow them to recover the efficient costs incurred in providing haulage services over the expected lives of the assets used and to earn a reasonable (but not a monopoly) rate of return on the value of the capital assets employed. The Code also provides for market-based incentives for haulage service providers to improve efficiency by allowing them to retain any additional profits earned by outperforming benchmarks adopted in setting Reference Tariffs.

The interests of those who might want access to pipeline haulage services are likely to be served by the measures in the Code which:

- prevent the abuse of monopoly power (including the reference tariff, ring fencing and hindering provisions);
- encourage the use of cost-based and economically efficient pricing structures for reference haulage services; and
- provide for disclosure of relevant information to market participants about the basis for reference tariff determination and establish independent dispute resolution and arbitration arrangements to resolve access disputes when they arise.

The public interest, including in having competitive markets will also be served by the code to the extent that it prevents the abuse of monopoly power, encourages efficient, cost-based pricing of haulage services and encourages more effective competition and productive resource use in upstream and downstream markets, including those involving products and services using gas as an input to their production or service delivery. By-pass is an issue not addressed in the Code which has important implications for the interests of access seekers and the way by-pass rights are specified and enforced may warrant further attention.

The more general prospective competition and efficiency benefits from implementation of the gas access Code identified in section 3 of the paper are also matters to be taken into account under the public interest criterion of S 44ZZAA.

While this is not the place for an exhaustive assessment of the Code against the criteria of S 44ZZAA, it is evident from these brief observations that the Commission considers that the objectives and mechanisms of the Code conform quite well to the general objectives, framework and assessment criteria of the industry code approval process which the Commission is required to apply under Part IIIA.

4.2 ACCC Comments on Particular Code Issues

Notwithstanding the general conformity of the Code with the Commission's assessment criteria, the important issue for the Implementation Group at this stage of its consideration of the alternative Part IIIA approval processes, is whether the ACCC considers there are deficiencies in the more detailed provisions of the Code which would undermine its effectiveness as an access regime sufficiently to bring its approval by the ACCC into question or to require substantial changes to the Code before it could be approved by the ACCC.

There are a number of aspects of the Code that the Commission considers raise issues that would require careful examination and assessment in its public consultation and code approval processes. These are examined below.

Relationship between undertakings and access arrangements

Section 44ZZA requires operators of individual pipelines to submit undertakings to the ACCC for approval against the relevant criteria as the means of obtaining protection from declaration under Part IIIA. Where an industry code has been approved by the ACCC under the amended section 44ZZAA, undertakings based on that code must still be submitted to the ACCC for approval against the criteria but a public consultation process is not required in that case.

The Code provides for operators of pipelines covered by the Code to submit access arrangements to the Regulator for approval which are based on the requirements of the Code and set out the policies and the terms and conditions of access that will be applied by those operators.

Thus, a three staged approval process would be required, involving approval of the Code and individual access undertakings by the ACCC and approval of detailed access arrangements for individual pipelines by the Regulator.

The question has been raised of whether the ACCC would be prepared to accept brief (so-called "one line") undertakings from pipeline operators, to the effect that they undertake to abide by the access code, on the basis that detailed access arrangements based on the Code will also be given to the Regulator, albeit under a process outside of the ACCC's Part IIIA approval process.

Legal advice is being sought on whether a one line undertaking based on an approved code could be accepted by the ACCC as a technical legal matter. However, assuming it is legally possible, the ACCC would also have to be satisfied that each one line undertaking to abide by the Code satisfied the assessment criteria under S. 44ZZA.

An important consideration here will be whether the Code provides sufficient guidance and detail on the principles and terms and conditions of access that are required, for the Commission to be satisfied that the detailed access arrangements that would be applied by individual pipeline operators (as set out in their access arrangements to be approved by the Regulator) would be in the interests of access seekers and the public as well as the operator, as required by the assessment criteria. It is relevant here that the gas access Code provides considerable discretion to the pipeline operator and the Regulator regarding the detailed access terms and conditions that may be specified in access arrangements.

A further consideration would be the identity and independence of the Regulator(s) responsible for reviewing access arrangements and the criteria and processes they would be obliged to apply in that role. While the ACCC will be responsible for the regulation of transmission pipelines, under the Code, state regulators will regulate distribution networks. Differences in the independence of those regulators and in the criteria and procedures they are required to adopt and in the transparency of their decision-making could possibly lead to subsequent approval of access arrangements which are inconsistent with the objectives and framework of the Code or which fail to satisfy the Commission's undertakings assessment criteria in practice.

These and related considerations suggest that it would be difficult for the ACCC to accept simple one line undertakings from all pipeline operators while at the same time being satisfied that those undertakings would satisfy the S.44ZZA assessment criteria.

The Commission is mindful, however, of concerns about the cost and timing implications of the need for three levels of approval for the gas access arrangements and would consider the option of developing a brief standardised undertaking to be submitted by all pipeline operators, to the extent that it comes to a firm view that one line undertakings would not satisfy the Part IIIA undertakings assessment criteria.

This is clearly an area for further discussion and work by the ACCC and the Implementation Group.

Coverage under the Code

The coverage section of the Code identifies (in Schedule A) pipelines that are automatically covered by the Code's requirements and establishes a case-by-case process for determining whether other pipelines should be covered. At any time, therefore, certain pipelines may not be covered by the Code or be bound to apply an approved access arrangement, either because they are not Schedule A pipelines, they have not been subject to coverage through the case-by-case assessment process or they have not volunteered to submit an access arrangement to the regulator.

The question has been raised of whether an uncovered pipeline could submit a one line or very brief undertaking to the ACCC to the effect that it would abide by the Code at some future time if and when it was subject to coverage under the case-by-case process or it volunteered an access arrangement. The objective would be for uncovered pipelines to avoid the risk of Part IIIA declaration, to abide by the Code to the limited extent of being subject to the case-by-case coverage process but to

exercise the discretion of avoiding the access obligations of the Code until coverage formally applied to those pipelines.

Again there is a question as to whether the ACCC could accept undertakings in those circumstances as a narrow legal matter and advice has been sought on that matter.

One issue for consideration in that context is whether it would be appropriate to accept an undertaking from uncovered pipelines which may not satisfy the coverage and Part IIIA declaration criteria (which are very similar), for example, because access to them would not promote competition in another market and/or that access would be contrary to the public interest. One the one hand the risk of declaration in such circumstances would be low and on the other acceptance of an undertaking in relation to such pipelines would probably be contrary to the objectives of Part IIIA even though S.44ZZA does not replicate the declaration criteria.

However, even if the answer to the legal question is yes, the Commission would still need to be satisfied that an undertaking of that kind by uncovered pipelines would satisfy its Part IIIA undertakings assessment criteria.

A reasonably persuasive case can be argued that it would be more efficient and the public interest would be better served by having uncovered pipelines regulated through the gas access Code (if deemed to be covered at some future time) rather than having them subject to the risk of Part IIIA declaration and so to a quite different regulatory regime.

In reaching a view on this matter, the Commission would need the benefit of legal advice on both the one line and uncovered pipeline undertakings proposals. It would also need to be satisfied that the coverage arrangements set out in the Code will produce outcomes that are consistent with the overall objectives and requirements of the Code and with its Part IIIA undertakings approval criteria. In particular, the Commission would need to consider the membership, credentials and guiding principles and criteria applying to the Coverage Advisory Body and the principles, constraints and appeal mechanisms applying to the Coverage Decision-maker.

It can be argued against accepting such an undertaking from uncovered pipelines that those pipeline operators always have the discretion and the incentive to volunteer to be covered by the Code by submitting an access arrangement to the Regulator should their legal and commercial advice indicate that they are at risk of Part IIIA declaration. This line of argument also suggests there would be merit in retaining the threat of Part IIIA declaration outside of the access arrangements specified in the Code.

The Commission's preliminary view is that acceptance of one line or brief undertakings from uncovered pipelines is likely to be difficult having regard to the undertakings assessment criteria and that in any event the consequences of not doing so are unlikely to be serious for the reasons mentioned above.

However, the Commission is willing to explore this issue further with the Implementation group and with industry representatives.

Ring fencing

The Commission is very mindful of the scope for misuse of market power when the ownership of monopoly infrastructure facilities (such as transmission and distribution pipelines) is vertically integrated with the ownership of competitive activities (such as gas production, wholesaling and retailing). The Commission has been a long time advocate of structural separation (where that would be economic and feasible) in such circumstances or failing that effective ring fencing of the monopoly and competitive activities of vertically integrated public utility businesses.

The ring fencing provisions of the Code appear to adopt a sound approach to dealing with this vertical integration problem and to achieve a good balance in providing restrictions on anti-competitive discrimination, appropriate separation of competitive and monopoly activities and reasonable transparency of the arrangements. At the same time, they seek to moderate the compliance burden on the service provider.

The discretion available to the regulator to require additional ring fencing arrangements in appropriate circumstances is sensible. This is an area, however, where some guidance from the Regulator as to the circumstances in which it may exercise this discretion and the kind of requirements it may impose would be of assistance to pipeline service providers and users.

Overall, the Commission believes the ring fencing arrangements are a very positive feature of the Code which should contribute to the interests of access seekers and to the promotion of competition in upstream and downstream markets while safeguarding the legitimate commercial interests of service providers.

Reference tariff principles

Overall the Commission's initial view is that the approach to reference tariff determination set out in the code appears to strike an appropriate balance between the interests of pipeline operators, access seekers and the public at large.

The Commission supports the Code's emphasis on efficient cost-based pricing while providing the regulator with the flexibility to apply the most appropriate pricing and incentive mechanisms on a case-by-case basis. The Commission also considers that the flexibility available to the Regulator in determining the value of the initial capital base for existing pipelines is sensible. This issue is of central importance in public utility pricing and, as views are far from settled as to the appropriate methodology and approach to adopt, a flexible and pragmatic approach is needed. The emphasis on "optimising" the value of the capital base by removing redundant or partially redundant assets, on the cost-reflective allocation of costs to references service tariff structures and on the use of incentive mechanisms in reference tariff design are all features which should contribute to achieving efficient regulated price outcomes under the reference tariff arrangements.

At the same time, the Commission has some remaining concerns about aspects of the reference tariff principles.

Perhaps more than any other section of the Code, pricing issues are most likely to be the cause of disputes between service providers and access seekers. Within the Code's general framework of principles, the discretion and flexibility available to the Regulator in applying the pricing principles can give rise to widely varying outcomes in practice, including outcomes that may not be consistent with the objectives of the Code or the Part IIIA assessment criteria.

The effectiveness and efficiency of the implementation of the Code's pricing principles will therefore depend largely on the ability of the Regulator(s) to require or design Reference Tariffs that replicate, as far as possible, outcomes that would be achieved in a competitive market.

The Commission will therefore need to be satisfied that the Regulator, the principles and criteria it is required to apply and the processes it establishes are likely to deliver acceptable competitive outcomes while meeting the legitimate interests of pipeline service providers, service users and the public at large.

As indicated above and in section 3 the Code and the reference tariff principles appear to strike this balance reasonably effectively but there are matters of detail and of implementation that will require closer examination during the formal approval processes, should the industry code/undertakings approval process be adopted.

Unbundling of gas and haulage services

As noted in section 3, the Commission considers that the unbundling of gas and haulage services through the Code's access arrangements is fundamental to achieving the competition and efficiency gains being sought by the gas industry reforms. As part of this unbundling, market participants should be free to contract separately for gas and haulage (or to purchase a bundled product if they choose) at any point in the production chain from the production plant gate to the user's plant.

The requirement in section 11 of the Code that producers are required on request to specify the price and terms and condition of gas supply at the producer's production plant gate will be central to achieving effective unbundling of gas and haulage in practice. Otherwise it could be possible for producers to frustrate the objectives of access and unbundling by only quoting gas prices at some downstream delivery point, inclusive of haulage service costs.

For these reasons, the Commission supports the objectives of the unbundling provisions of the Code and considers they should contribute to the interests of haulage service providers, access seekers and the public by promoting competition and more efficient trading activities.

Further thought may need to be given to the effective enforcement of section 11 of the Code, to the extent that gas producers may not be "covered" service providers under the Code. In the national electricity code reform model, all industry participants are required by state legislation to be signatories to the Code and hence to agree to be bound by the Code as enforced by NECA. Would gas producers be similarly required to be signatories to the gas Code to the extent its provisions apply to them or will it only apply to pipeline service providers?

Preventing or hindering access

A major objective of the Code is to prevent misuse of the monopoly position held by gas transporters by establishing a third party access regime and by placing constraints on monopoly pricing. The clauses in the Code which address such matters will play a central role in delivering effective competition in downstream gas markets.

However, similar care also needs to be taken to ensure that monopoly pipeline operators, or large existing pipeline users, do not abuse their dominant positions in other ways.

In this respect it is very important for the Code to discourage pipeline owners from using their market power to their own benefit or to the benefit of an affiliated company to the detriment of pipeline users and competitive market outcomes. This latter point is particularly relevant for the gas industry which is characterised by relatively few pipeline companies which often operate in a vertically integrated way or as part of joint venture operations.

The Task Force clearly recognised this difficulty when it discussed the Code's *Hindering* clause 7(1) in the Information Paper (GRTF 1996 p.87). The Commission agrees with the Task Force that the evidence requirements for a purpose based test of hindering are significant. So much so, that the Commission believes that the current clause dealing with hindering activities could prove to be ineffective due to the evidentiary requirements. The Code would therefore be less effective in preventing conduct designed to and having the effect of hindering access to gas pipelines. As this relates to one of the key objectives of the Code, the Commission believes that the current hindering clause may need to be strengthened to establish a binding constraint on the abuse of market power by gas pipeline owners or users.

Similar concerns are being addressed in the case of access arrangements for telecommunications - under the Trade Practices Amendment (Telecommunications) Bill 1996. In this case, the dominant position of the telecommunications infrastructure owner is recognised and a 'purpose or effects' test for anti-competitive behaviour is included in the access regime. Concern that the regulatory net may be cast too widely, and prohibit some normal competitive behaviour, is addressed by allowing the service provider to seek authorisation for such behaviour.

The Commission believes that a similar approach could also be adopted for the gas Code. This approach would ensure that the Code is binding in its ability to address concerns about the abuse of market power. It would also provide firms with the flexibility to seek approval to engage in socially and economically desirable activities which could otherwise be construed as hindering access.

Safety and technical issues

The Commission also has remaining concerns about the Code's approach to disputes involving safety and technical issues which it believes are capable of producing anti-competitive market outcomes.

The reasoning behind the Code's approach to safety and technical issues appears to be that the Service Provider is in the best position to determine whether the requested access would pose a threat to the integrity of its system and it will be held responsible if there is a problem. As a result, the Code requires that the Regulator should not make binding determinations where a Service Provider believes such determinations would threaten the integrity of its system. For example, in disputes about pipeline capacity, s.6(15) of the Code provides that the regulator must not grant access to the service if the Service Provider **believes** there is insufficient capacity within safe operating limits and prudent pipeline practice. This **belief** is unchallengeable, and creates the potential for opportunistic misuse of this discretion for anti-competitive purposes.

The Commission has a number of concerns about this approach in the Code.

Under the current version of the Code, if a dispute did arise over safety or technical issues, relief is provided to the access seeker either by them being supplied with interruptable capacity or by the capacity of the pipeline being increased. In either set of circumstances, it would be open to the Service Provider to frustrate access for example by:

- providing interruptable capacity but creating circumstances required for interruptions; and/or
- unnecessarily increasing the capacity of the pipeline at a significantly higher cost to users.

Either of these circumstances could amount to hindering of access which would be undesirable. However, in order to avoid protracted and difficult proceedings to determine whether hindering has occurred, it would be preferable for the Code to provide a mechanism to allow the safety and technical facts of a case to be determined at the time access was requested.

The Commission has concerns about the underlying proposition that Regulators should not make determinations where a Service Provider believes such a determination would leave it exposed financially or raise safety issues. It is the task of the regulator to independently determine the facts of a dispute, to balance the competing needs of the Service Provider against those of users and the wider public interest, in circumstances where one of the parties possesses monopoly power. It is not clear to the Commission why safety and technical issues should be treated any differently.

However, this is not to say that regulators should be given unlimited powers or the ability to act in an arbitrary fashion in this important area. To ensure that any determinations are rigorous and well founded, the Code could require the regulator to seek independent technical advice from an expert panel. Given the nature of the expertise required, it could be expected that such a panel would largely be comprised of industry representatives which do not have a direct interest in the dispute.

Provision of information to the Regulators

The ability of the Regulator to obtain all information necessary to fulfil its functions under the Code will be critical to the effectiveness of the Code and the Regulator's role under it.

This point was borne out by the process leading to IPART's draft determination on the AGL undertaking under the NSW gas Code. In that case, we understand that the service provided maintained that cost information sought by the Regulator was not available in the company information system.

The Commission believes that the Regulator needs to be able to both:

- require service providers to maintain records of specified kinds of cost and other data necessary for regulatory purposes; and
- require service providers to provide such information to the Regulator in a timely manner and in formats which will enable the Regulator to perform its regulatory role.

The provisions in section 7 of the Code provide comprehensive information gathering powers for the Regulator which should cover both of theses requirements and so contribute to the effective administration of the Code.

Dispute resolution and arbitration

Effective dispute resolution and arbitration arrangements are of central importance to the effectiveness of the Code. At the same time, the Commission agrees that there should be sensible limits on the range of matters that can be subject to an access dispute.

In general, the Commission considers the dispute resolution arrangements set out in section 6 of the Code appear to strike on appropriate balance in that respect and to establish appropriate principles and processes for the resolution of disputes regarding access.

One matter that has been the subject of some comment is the requirement in the Code that the Regulator apply only the reference tariff in resolving a dispute about a reference service.

On one hand it is evident that the reference tariff is intended to be an efficient, cost-based price for a reference service which provides both a benchmark for commercial negotiation of non-reference services and a fall-back price should negotiations fail or disputes arise. Allowing arbitration of disputes about reference prices for reference services would undermine this basic feature of the Code and invite market participants to by-pass the Code's up-front regulation process and go directly to arbitration for most transaction negotiations.

On the other hand, the reason for concern that the Regulator's reference tariff decision cannot be subject to review is that it is possible that the Regulator may determine a reference tariff for third parties which is inconsistent with the commercial and competitive realities of the market and so with the objectives of the Code.

This is a genuine concern which needs to be addressed in an appropriate way. One possible approach is to note that the Code requires the Regulator to apply the efficient cost-based and cost allocation principles and methodologies set out in section 8 and to allow a review of the reference tariff determination **only** on the grounds that the Code's principles and criteria have not been applied by the Regulator. That is, there could be a review of the Regulator's process in applying the pricing principles and requirements of section 8 but not of the assessment made in conformity with those principles in making its reference price determination.

This is an important and difficult issue that will require further analysis and discussion irrespective of whether the "effectiveness" or "undertakings" approval process is followed.

Establishing independent regulators

A recurring issue throughout this paper has been the role of the Regulator under the Code and particularly the need for the establishment of independent regulators with statutory responsibilities and guiding principles that are consistent with the administration of the Code in accordance with its overall objectives.

It is a central part of the Regulator's task to balance the competing interests of market participants against the wider public interest in promoting competition and the efficient development of the gas industry. However, this task may be compromised or distorted if the Regulator is not independent from the other policy development and implementation functions of government. If Ministers or their delegates are given the Regulator role in some jurisdictions there is the potential for conflicts to arise between their broader policy responsibilities and the regulatory functions under the Code.

Having statutorily independent regulators in the regulatory role under the Code will therefore be important both to the efficiency of the regulatory task and to the practice and appearance of objectivity and independence in the administration of the Code.

The independence of regulators under the Code and the statutory framework and principles under which they operate will be particularly important for the gas regulation role because, as noted above, the Code is a very flexible document which gives the Regulator considerable discretion in the interpretation and application of many of its important access principles.

The view the Commission takes ultimately on issues such as undertakings, coverage and the extent to which the Code needs to be a stand alone document (rather than one to be read in conjunction with legislation, licence arrangements and access arrangements) will depend importantly on the independence of the Regulator(s) and their statutory responsibilities.

5. Undertakings procedural issues

This section comments briefly on:

- the nature and timing of the ACCC's processes for approving industry codes and access undertakings;

- arrangements for enforcing the Code and Part IIIA undertakings; and
- processes for approving changes to the Code.

5.1 Processes and timing of industry code approvals

The formal approval process for a major industry code such as the gas Code would normally take about 4 to 5 month, recognising the need to call for and consider public submissions and the Commission's normal practice of issuing a draft determination for comment before reaching a final decision.

The steps in the process are normally to publish the Code and an issues paper soon after the application is lodged. The deadline for submissions is usually about two months later with a draft determination being published some 3 months after the application is received based on internal analyses and market place discussions on key submissions.

Round table meetings may be held to obtain feedback on the draft determination and a final determination would be issued 4 to 5 months after the application is made.

This indicative timetable may be shortened if the Commission has had the opportunity prior to receipt of the application for informal consultations with governments and market participants on the Code and those consultations have resulted in sensible refinements and a general level of agreement on and support for the Code. The consultation processes of the previous GRTF and now the Implementation Group with regulators and market participants will be important in that respect.

On the other hand, should the public consultations (both informal and formal) raise significant issues and problems regarding the Code which need to be addressed with the applicant and participating governments, the indicative timetable outlined above would be extended.

The timing of the approval process for access undertakings based on the Code is more difficult to assess and will depend among other things on the view the Commission takes on the one line undertaking proposal. As indicated above, should the Commission decide against the one line undertaking option (on legal advice and its own assessment of its Part IIIA responsibilities), it would then consider options for standardising the undertakings it would require and for streamlining the approval processes involved.

This issue and the timing implications will require further analyses and discussion by the ACCC and the Implementation Group.

5.2. Enforcement of the Code and Part IIIA undertaking

It has been noted that if the access undertakings approval process is adopted, service providers under the Code would be subject to two different enforcement mechanisms: actions taken by the Regulator to enforce compliance with the Code and the related access arrangements **and** actions taken by the ACCC to enforce compliance with access undertakings given under Part IIIA based on the industry code.

While this may be the formal legal position, as a matter of administrative practice, the Commission would always seek to ensure that the dispute resolution and enforcement arrangements of the Code were used to the maximum extent possible to deal with disputes and Code breaches. In particular, provided it were satisfied with the details of the Code's enforcement mechanisms, it would resist attempts to use its undertakings enforcement mechanism to bypass the enforcement arrangements in the Code and related undertakings that it had previously approved under Part IIIA.

Its undertakings enforcement procedures could and would be applied where there was evidence that the Code's enforcement arrangements were not being applied to address a serious breakdown in the application of the Code's access arrangements or the Code's enforcement arrangements were not capable of or suited to dealing with the problem.

Subject to further discussion on efficient and practical application of this hierarchy of dispute resolution and enforcement mechanisms, one option for ensuring that it is applied in the manner described above would be for that intention to be formalised in an exchange of letters between the ACCC Chairman and participating jurisdictional governments.

As an aside, the one line undertakings proposal discussed above may be subject to the further objection that it would be incapable of enforcement in the courts as required by Part IIIA because the Code to which it relates is too general and flexible to be enforced on the basis of a one line undertaking by individual pipeline operators

5.3 Processes for approving changes to the Code

The Code will inevitably require changes over time based on experience with its administration. Having obtained approval for such changes under the Code change process set out in section 9 of the Code, the Code Administration Committee would need to submit the changes to the ACCC to obtain its consent as required by S.44ZZAA.

The ACCC is not legally required to conduct public consultations on such Code changes but in the interests of natural justice and industry-wide acceptance of any code changes it may well do so where the nature of the changes warrant. Public inquiries may not be warranted in many cases, however, for example, if the public consultation process under the Codes code change arrangements were comprehensive and had involved the ACCC. Alternatively, the amendments concerned may be minor in nature and not worthy of wide discussion or debate.

Efficient arrangements can also be developed to separate the approval processes for minor matters from those for matters of substance, on the lines to be applied by the ACCC for changes to the national electricity code. Under those arrangements, changes of substance are to be brought to the ACCC for assessment and approval as soon as they are approved under the relevant code change process. Minor matters are to be accumulated and brought to the ACCC six monthly or annually to be approved as periodic code housekeeping arrangements.

6. Concluding comments

The observations made in this paper represent the Commission's initial views on how the gas Code measures up against the Part IIIA industry code assessment criteria. The paper has been prepared at short notice to assist the Implementation Group's consideration of the relative merits of the alternative Part IIIA approval processes and does not reflect a detailed consideration by the Commission of the acceptability of the Code in terms of the S.44ZZAA assessment criteria.

Nevertheless, as indicated in section 4.1 of the paper, the Commission considers at this stage that, viewed in general terms, the Code stands up quite well against the Part IIIA criteria for accepting industry codes.

More generally, as indicated in section 3 of the paper, the Commission considers that access arrangements of the kind set out in the Code are essential pre-requisite for effective unbundling of gas production and supply from gas transportation and for the promotion of vigorous competition and new entry in an efficient and growing Australian gas market.

The areas of the Code identified in section 4.2 about which the Commission has some remaining misgivings do not appear to raise concerns which are fatal to approval of the Code under the S.44ZZAA criteria. On the contrary the Commission considers that they should all be amenable to resolution through discussion and negotiation and where appropriate by way of appropriate refinements to the Code in the context of the Commissions overall assessment of the Code against the reasonably broad criteria which it is required to take into account.

The Commission is ready to discuss those issues more fully with the Implementation Group and industry participants.

The timing and procedural issues discussed in section 5 of the paper will also require further discussion by the Commission and the Implementation Group. Again the issues raised seem amenable to resolution through discussion and negotiation.

The Commission welcomes this opportunity to put its views on the Code to the Implementation Group.