DLA PIPER

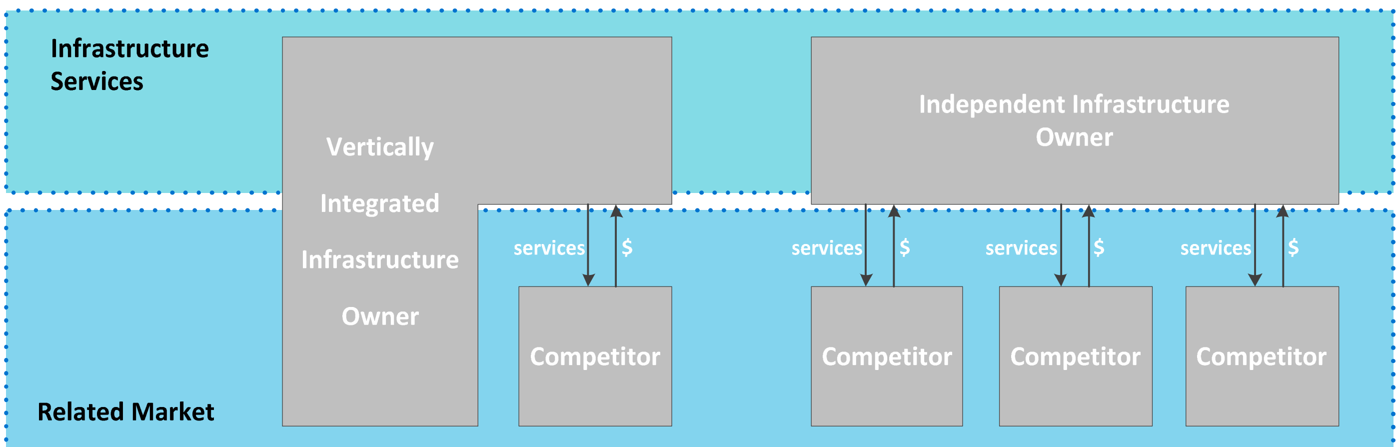
2 NOVEMBER 2015

COMPETITION & REGULATION UPDATE

A lower bar for coverage of gas pipelines?

The regulation of gas transmission pipelines faces significant reform. The Australian Energy Market Commission (AEMC) has proposed amending or removing criterion (a) from the Coverage Criteria. This would represent a very significant reform and would certainly lower the bar for coverage. It could also have implications for access regulation in other industries. However, it is far from clear that criterion (a) needs to be removed in order coverage applications to succeed.

Criterion (a) currently limits coverage to circumstances where access (or increased access) provides a material increase in completion in a related market.



ILLIQUIDITY OF SHORT TERM CAPACITY RIGHTS ON GAS TRANSMISSION PIPELINES

Access to gas transmission pipelines is an increasingly critical issue in eastern Australia as the relative stability of long term Gas Transportation Agreements (GTAs) is replaced by a dynamic industry in which domestic demand for gas competes with volatile global LNG markets. Reviews have been or are being completed by the AEMC, Australian Competition and Consumer Commission (ACCC), Australian Energy Market Operator (AEMO) and Productivity Commission. Reform to some degree is inevitable. The existing reviews point toward a more uniform set of arrangements which better facilitate short term trading of gas.

Gas markets of course require gas transportation capacity. Although a network of gas transmission pipelines run throughout eastern Australia, it is common ground that the current lack of flexibility in gas transportation rights is likely to prevent gas markets in the future from operating efficiently, particularly as the full impact of LNG plants in Queensland emerges and contractual timeframes shrink.

Despite uniform legislation, the ability of shippers to access gas pipelines is far from uniform. Of the 21 major transmission pipelines in eastern Australia, only two are subject to full regulation under the *National Gas Law* (NGL) while three are subject to 15 year no coverage determinations. Much access occurs pursuant to long term bespoke GTAs, the terms of which are not transparent. In addition, the divergent approaches to gas transmission rights between States adds a layer of complexity. Victoria's declared transmission system facilitates flexibility in short term transmission capacity by treating capacity rights as a part of the declared wholesale gas market. In contrast, pipelines in other States generally operate on a carriage by contract basis which has not proved conducive to the trading of short term capacity. Despite pipeline owners establishing capacity trading portals, trading has been illiquid. Interestingly, the Victorian approach has, true to purpose, resulted in greater diversity of gas retailers.

ACCESS THROUGH COVERAGE

Shippers seeking access to capacity rights have various options including seeking coverage of a pipeline under the NGL.

The history of coverage determinations confirms that coverage is not easy to obtain. The ministerial decision to cover the Eastern Gas Pipeline was overturned by the Tribunal in 2000. Coverage of the Moomba to Adelaide Pipeline System was revoked in 2007. In 2012, the relevant Minister decided that the South East Gas Pipeline should not be covered. Coverage of the Dawson Valley Pipeline (which had been granted in 2006) was subsequently revoked in 2014.

One of the major reasons for past decisions not to cover pipelines is that criterion (a) is not satisfied. In its discussion paper regarding gas Pipeline Regulation and Capacity Trading dated 18 September 2015 (PRCT Paper), the AEMC suggests lowering the bar to coverage by amending or removing criterion (a).

COVERAGE CRITERIA

The pipeline coverage criteria in section 15 of the NGL (Coverage Criteria) are currently virtually identical to the declaration criteria under Part IIIA of the *Competition and Consumer Act 2010* (Cth) (CCA).

Criterion (a) of the Coverage Criteria is satisfied if:

> *"access (or increased access) to pipeline services provided by means of the pipeline would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the pipeline services provided by means of the pipeline"*

REMOVING CRITERION (A) FROM THE COVERAGE CRITERIA

The PRCT Paper suggests that the coverage regime should operate to prevent gas pipeline owners from exercising market power, but that it may not be having that effect because the bar for coverage is inappropriately high. The stated rationale is:

- the Part IIIA access regime (on which the coverage criteria are based) was only intended to address circumstances where the owner of a monopoly facilities also competes in the relevant dependent market (ie is vertically integrated such as in the diagram on page 1);
- gas pipeline owners in Australia are in almost all case vertically disaggregated; and
- in consequence, gas pipelines may not satisfy the Coverage Criteria.

In essence, the AEMC suggests that if the purpose of coverage is to prevent gas pipeline owners from exercising monopoly power, then removing criterion (a) would result in better targeted coverage test.

IMPLICATIONS OF REMOVING CRITERION (A) FROM THE COVERAGE CRITERIA

Removing criterion (a) from the Coverage Criteria would certainly lower the bar for coverage.

However, it is far from clear that criterion (a) needs to be removed in order coverage applications to succeed. Criterion (a) does not make the Part IIIA access regime so limited as to apply only to infrastructure owners who are vertically integrated. For example, airside services at Sydney Airport were declared under Part IIIA by the Australian Competition Tribunal (Tribunal) in 2005 (Virgin Blue Decision) despite the fact that the owner was precluded by legislation from holding any significant share in any airline (although the Tribunal did find that the owner may, for other reasons, have sought to confer competitive advantages on Qantas, its largest customer).

Furthermore, in its recent draft decision in the Port of Newcastle matter, the NCC observed that even though the port owner was not vertically integrated, this did not preclude declaration under Part IIIA. The NCC stated:

> *"Not all, indeed possibly only a small subset of, price disputes or situations where prices may appear or be "excessive", "monopolistic" or "gouging" will fall within the ambit of Part IIIA. The declaration criteria, in particular criteria (a) and (b), limit the ambit of the National Access Regime ...*
>
> *The Council acknowledges that Glencore's concerns regarding the charges levied by PNO for the service ... could be characterised as a pricing dispute. Even so, this does not rule out the possibility of there being an impact on competition in a related market, and the prospect that criterion (a) could be satisfied."*

Criterion (a) operates to limit the availability of coverage, or declaration. It is not necessarily the case that all essential infrastructure should be covered or declared. This is a policy issue fraught with difficulty, and an issue that may impact future investment decisions. As the Hilmer Report observed:

> *"The efficient operation of a market economy relies on the general freedom of an owner of property and/or supplier of services to choose when and with whom to conduct business dealings and on what terms and conditions."*

The impact of removing criterion (a) depends to a degree on how it is interpreted. Presently, the interpretation is far from certain. The Full Federal Court suggested, arguably in non-binding *obiter dicta*, that criterion (a) of Part IIIA should be determined by reference to a with or without access test (in contrast to the with and without declaration test that the Tribunal in the Virgin Blue Decision). Since that time, the Australian Government has accepted the recommendation of the Productivity Commission that criterion (a) should involve a comparison of competition with and without access on reasonable terms and conditions through declaration and has committed to developing exposure draft legislation to amend Part IIIA. It is presently unclear whether the Coverage Criteria would be amended along with any amendment to Part IIIA.

In the context of pipelines, the impact of existing GTAs adds to the uncertainty in respect of the application of criterion (a). The NGL provides that an access determination may not deprive a person of a relevant protected contractual right. The time

period relevant to assessing criterion (a) in respect of a gas pipeline may be 10 years or more. As such, the length and terms of any existing GTAs are likely to be relevant. As the Tribunal observed in relation to Fortescue Metals Group's application (FMG Rail Matter):

> *"if there is no spare capacity for third party use then, unless the facility can be expanded, a declaration would be futile."*

The uncertainty associated with criterion (a) could itself be a factor dissuading shippers from making coverage applications, both because of the uncertainty of the result and the time and cost that is involved in dealing with each of the possible interpretations. It is possible this uncertainty may be resolved either by legislative change (following the Harper Review) or through a Tribunal or Court decision, for example in the Port of Newcastle matter).

CONCLUSION

Removing criterion (a) from the Coverage Criteria would represent a very significant reform and would certainly lower the bar for coverage. However, it is far from clear that criterion (a) needs to be removed in order coverage applications to succeed. The issue raised by the AEMC is a policy issue fraught with difficulty, and an issue that may well impact future investment decisions.

MORE INFORMATION

We welcome the opportunity to discuss these issues in further detail. For more information, please contact:

Simon Uthmeyer
Partner
T +61 3 9274 5470
simon.uthmeyer@dlapiper.com

Alec White
Senior Associate
T +61 3 9274 5144
alec.white@dlapiper.com

Or contact your nearest DLA Piper office:

BRISBANE

Level 29, Waterfront Place
1 Eagle Street
Brisbane QLD 4000
T +61 7 3246 4000
F +61 7 3229 4077
brisbane@dlapiper.com

CANBERRA

Level 3, 55 Wentworth Avenue
Kingston ACT 2604
T +61 2 6201 8787
F +61 2 6230 7848
canberra@dlapiper.com

MELBOURNE

Level 21, 140 William Street
Melbourne VIC 3000
T +61 3 9274 5000
F +61 3 9274 5111
melbourne@dlapiper.com

PERTH

Level 31, Central Park
152–158 St Georges Terrace
Perth WA 6000
T +61 8 6467 6000
F +61 8 6467 6001
perth@dlapiper.com

SYDNEY

Level 22, No. 1 Martin Place
Sydney NSW 2000
T +61 2 9286 8000
F +61 2 9286 4144
sydney@dlapiper.com

www.dlapiper.com

DLA Piper is a global law firm operating through various separate and distinct legal entities.

For further information, please refer to www.dlapiper.com

Copyright © 2015 DLA Piper. All rights reserved.

1202928323 | NMG | 1115

This publication is intended as a first point of reference and should not be relied on as a substitute for professional advice. Specialist legal advice should always be sought in relation to any particular circumstances and no liability will be accepted for any losses incurred by those relying solely on this publication.