FREE AND FAIR TRADE IN GAS: THE QUEENSLAND ACHIEVEMENTS

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1 The NCP Reforms

National Competition Policy (NCP) is one of a suite of policies contributing to Australia's strong economic performance in the late 1990s. One of the clearest benefits of reform has been Australia's recent productivity performance, averaging 2.4 per cent over the last six years – one of the highest rates in the developed world.

This result largely reflects technological innovation in services such as communications, business and financial services and Australia's relatively well-educated and cost efficient labour force. But NCP is contributing in many ways – by reducing the cost of business inputs, improving the efficiency of government businesses and raising the productivity of infrastructure.

According to the OECD and IMF, these changes are helping to create a more flexible and adaptable Australian economy. The RBA has commented that Australia's more resilient economy has helped it weather the recent instability in East Asia. Against the odds, the economy has maintained a strong growth performance while maintaining low inflation.

In summary, the NCP reforms agreed by governments in 1995 were to:

- *widen Australia's general trade practices laws* by extending the reach of Part IV of the Trade Practices Act (TPA) to apply to all businesses in Australia.

- *improve the quality of Australia's infrastructure* through reform packages in the electricity, gas, water and road transport industries; and establishing third party access arrangements for the services of nationally significant monopoly infrastructure such as gas pipelines, electricity grids and railway lines;

- *review and, where appropriate, reform all laws which restrict competition*, and ensure that any new restrictions provide a net community benefit; and

- *improve the performance of government businesses*.

A number of these reforms have implications for the gas industry. I plan to talk about two areas in particular:

- the access reforms;

- national reforms to promote free and fair trade in gas.

2 The Access Reforms

Perhaps the most significant NCP reform for infrastructure industries was the creation of a national access regime, set out in Part IIIA of *the Trade Practices Act*. While the use of access regimes predates the 1995 NCP reforms in a number of States – including Queensland – Part IIIA sets out a national approach to access regulation for the services of significant natural monopoly infrastructure.

The rationale for access regulation is that the natural monopoly characteristics of some infrastructure markets can inhibit competition in upstream and/or downstream markets, with adverse consequences for consumer welfare and efficiency. For example, if an electricity grid owner were free to charge monopoly prices, consumers would ultimately bear the burden through inflated power charges. A denial of access may even result in wasteful duplication – from a social viewpoint – of infrastructure resources.

The access reforms establish principles to achieve competitive outcomes in significant natural monopoly infrastructure markets. Essentially, the reforms promote access negotiation supported by credible dispute resolution procedures within a regulatory framework.

The Council plays a number of roles in the access reforms. In particular, it makes recommendations to relevant Ministers on:

- applications from potential users to declare infrastructure services for access under Part IIIA; and

- applications from State and Territory governments to certify their access regimes as 'effective' regimes. A certification gives the relevant infrastructure services immunity against being declared under Part IIIA.

To date, the Council has handled a range of declaration and certification applications. Much of the declaration activity has been in rail. A number of

certification applications have also covered rail services – for example, the Council released a draft recommendation on the WA Rail Access Regime in September. The other principal area of activity in certification has, of course, been gas – which I return to shortly.

Concerns are sometimes expressed that access regulation can deter decisions to invest in new infrastructure, or that it is an inappropriate intrusion on property rights, especially in relation to privately owned infrastructure. Some argue that access regulation heightens risk and undermines opportunities to earn blue-sky profits in high risk markets.

On the other hand, those seeking access argue that it is not sensible to force them to invest in new infrastructure at high cost to the whole community when existing facilities have spare capacity, and all users can be supplied at lower cost if existing facilities are shared.

The Council is keenly aware that natural monopoly regulation is intrusive, and that it should only be imposed where significant economic benefits arise. This is a highly targeted area of regulation applicable to a narrow range of monopoly infrastructure. And where access *is* needed to promote competition in related markets and the efficient utilisation of infrastructure, the Council would seek to minimise any disincentives for new investment.

Part IIIA of the Trade Practices Act recognises these things by:

- limiting the scope of access regimes to a narrow range of significant monopoly facilities;

- ensuring that regulatory and arbitration processes take into account the interests of infrastructure owners; and

- requiring that access regulation under Part IIIA must promote competition in other markets – thus ensuring that strong benefits must arise.

It should be borne in mind that the goals of promoting competition and fostering infrastructure investment are often mutually supportive. For example, new investment in infrastructure helps to promote access by making new capacity available.

At the same time, access can expand opportunities for investment by facilitating market growth upstream and downstream. For example, the National Gas Access Code is helping to expand the market for natural gas by

enabling customers to access spare and developable capacity in gas pipelines. This in turn is promoting new investment in transmission pipelines – such as the $3.7 billion PNG-Queensland pipeline.

3 The COAG Gas Reforms

NCP embraces reforms agreed in 1994 by the Council of Australian Governments (COAG) to achieve free and fair trade in gas – both within the States and across State borders. These reforms essentially form three strands:

- a national code for third parties to gain access to spare and developable capacity in transmission and distribution pipelines. The Code was developed by governments, the gas industry and gas customers to reflect the objectives of Part IIIA of the TPA;

- reform of regulatory barriers to free and fair trade in gas; and

- structural reform of gas utilities.

The gas reform package has already been responsible for some important reform achievements:

- the national third party code for access to transmission and distribution pipelines was signed off by all Australian governments in November 1997. The implementation legislation has been passed in all mainland jurisdictions[1], although it is not yet operational in Queensland;

- many pieces of legislation affecting free and fair trade in gas have been reviewed or are scheduled for review; and

- structural break-up or ring fencing of the old vertically integrated transmission, distribution and retailing monopolies has been completed or is well advanced in most jurisdictions.

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[1] Tasmania does not yet have a natural gas industry.

3.1 The Council's Role

The Council plays a number of roles in the gas reform process, three of which relate to third party access:

- first, the Council makes recommendations on applications under Part IIIA to declare services provided by significant infrastructure facilities such as gas pipelines. For example, the Council received an application from Futuris in September 1996 seeking access to the AlintaGas high-pressure gas distribution system. The application was later withdrawn following negotiations between Futuris and AlintaGas.

- second, where a State Government wants to avoid the risk of declaration of services in its jurisdiction, it can apply to the Council for certification that an existing State access regime is 'effective' under the *Trade Practices Act*. Implementation of the National Gas Access Code is following the certification route.

- third, the Council plays a number of ongoing roles under the National Gas Access Code. In particular, the Council handles applications for coverage of a pipeline – and revocation of coverage.

  The Council understands the need for certainty as to the likely coverage of new infrastructure and is available to advise investors on whether a proposed new pipeline would meet the coverage criteria. Alternatively, investors may seek coverage prior to construction of a new facility by adopting the Code's competitive tendering principles for new pipelines, or by submitting an access arrangement for the pipeline to the regulator.

  Conversely, revocation issues will arise from, for example, technological innovation and changing market conditions. During the last twelve months, the Council has received seven applications for revocation of coverage of pipelines under the National Code. All of the applications were made in respect of pipelines located in Western Australia. The Western Australian Minister for Energy, Resources Development, and Education accepted each of the Council's recommendations on these pipelines. Under the decisions, coverage was revoked in respect of five pipelines, while revocation was declined in respect of two.

- finally, the Council assesses State and Territory progress in implementing the NCP reforms. The Council must deliver a report to the Federal Treasurer in June of 1997, 1999, and 2001, on progress by each State. This advice forms the basis of the Treasurer's decision to allocate three tranches of competition payments to each jurisdiction from these dates.

As far as gas reform goes, the Council's future assessments will focus on two key issues:

- effective operation of the National Code, including the phasing out of transitional arrangements in accord with the November 1997 intergovernmental *Gas Pipelines Access Agreement* (1997 Gas Agreement); and

- the review and, where appropriate, reform of all legislative and regulatory barriers to free and fair trade in gas, including barriers in the upstream sector.

4 The National Code

The National Code is an important breakthrough in creating more competitive gas markets as it gives customers greater scope to negotiate with a range of gas suppliers, knowing that it is possible to access a pipeline to carry the gas to the required destination.

Although it is still early days, these developments offer the potential to expand the market for natural gas, fuelling the development of new pipeline proposals to link key gas basins with major markets. The $50 million Interlink pipeline from New South Wales to Victoria was opened in 1998, allowing natural gas trades between the two states for the first time. Implementation of the National Code helped underpin the construction of this pipeline, as it enabled parties to access the distribution networks in major markets like Melbourne.

Already, the Interlink has brought socio-economic benefits, allowing emergency supplies of gas to flow into Victoria from interstate when Victoria's gas production facility at Longford was immobilised in 1998. This enabled hospitals to be supplied with gas, and also enabled pressure to be maintained in the Victorian gas network, averting a major collapse of the system which could have shut down gas supplies in the State for several months.

A number of other proposals – like the AGL-Petronas pipeline from Papua New Guinea to Queensland, and the Eastern Gas Pipeline along the south-eastern seaboard – are well advanced. As the national pipeline grid fills out, the potential for interbasin competition is rising, with likely flow-on benefits in terms of gas prices. For example, construction of the AGL-Petronas pipeline will bring PNG gas into competition with Cooper Basin gas in Queensland markets.

4.1 Certification of State Regimes

One of the Council's primary functions with regard to the National Code is to consider certification of each State's application of the Code.

South Australia, as the lead legislator for the National Code legislation, was the first jurisdiction to have its access regime certified. This occurred in December 1998. The Council has made a recommendation on the NSW Regime to the Minister, although the Minister's decision has been delayed pending consideration of issues arising from the recent High Court cross-vesting decision in *Re Wakim; ex parte McNally*. The High Court decision has implications for the use of the Federal Court as an appeals body under the National Code.

This matter aside, the Council expected – and is finding – that for most jurisdictions, the certification process is raising only a handful of substantive issues. This was to be expected as the Council examined the effectiveness of the National Code in 1997 and recommended a number of amendments, all of which were implemented. As such, most potential certification issues were addressed back in 1997.

The issues the Council is currently considering for each of the State certifications are essentially:

- whether State regulators are independent of all parties, including governments, and whether they have sufficient resources to fulfill their work. While the ACCC is the regulator for transmission pipelines in all States other than Western Australia, State bodies will regulate distribution networks in most jurisdictions. This has required the establishment of new regulatory agencies in a number of jurisdictions.

- whether transitional arrangements for phasing in the National Code are consistent with the principles agreed by all jurisdictions in the 1997 Gas Agreement, and have sound policy merit; and

- the implications of any derogations (modifications, variations or exemptions) from the Code for its effective operation.

4.2 The Queensland Regime

While Queensland's application of the National Code is similar in many respects to that of other jurisdictions, there is one significant difference – it contains a number of derogations affecting several existing and proposed

transmission pipelines. The Council's public consultation process indicated considerable disquiet in the market with regard to these derogations. The Council's issues paper and submissions received can be viewed on the Council's website at http://www.ncc.gov.au

One of the effects of the derogations is to exempt, for a period, the application of the National Code's *pricing principles* (including the regulatory approval process) with respect to five transmission pipelines:

- Wallumbilla to Brisbane (pipeline license 2);
- Ballera to Wallumbilla (pipeline license 24);
- Wallumbilla to Rockhampton via Gladstone (pipeline license 30);
- Gatton to Gympie (pipeline license 32); and
- Ballera to Mt Isa (pipeline license 41).

Under section 58 of the *Gas Pipelines Access (Queensland) Act 1998*, these pipelines may have their tariff arrangements approved – once only – by the Queensland Minister by gazette notice. The Council understands that in most cases, the tariffs to apply would be those in effect prior to the introduction of the National Code. Queensland's certification application argues that the derogations are necessary to protect the commercial interests of pipeline owners with regard to pre-existing access principles negotiated prior to the development of the National Code.

The Council is unable to consider that the National Code applies to the five affected pipelines in the same way as it applies to other pipelines in that the derogations alter a number of fundamental processes in the Code.

Instead, the Council's approach has been to consider whether the regulatory processes for the derogated pipelines – including tariff outcomes – provide a *reasonable proxy* for the National Code, and if not, whether discrepancies are significant.

In order to process the Queensland application, the Council has sought the advice of the ACCC – given its responsibilities in gas transmission issues – on whether the Queensland Regime as it applies to the five affected pipelines is broadly consistent with the National Code, and the extent to which any differences are significant. For those pipelines whose reference tariffs were determined through competitive tendering, the ACCC will focus, in the first

instance, on the tendering *process.* However, this may require some consideration of tariff outcomes. For other pipelines, the ACCC's consideration must necessarily focus on tariff outcomes.

The Council understands that Queensland's willingness to provide information to assist the ACCC's consideration of the derogations required the resolution of a number of issues, including the treatment of commercial-in-confidence information. The Council understands that these issues have now been resolved and information on the tendering processes has recently been provided to the ACCC.

4.3 The PNG Pipeline

In addition to the derogations noted above, the Queensland Regime derogates, for a period, the access principles to apply to the PNG-Queensland pipeline. Access principles for this pipeline are being developed through a competitive tendering process, which commenced prior to the National Code being finalised. These arrangements were established under regulatory processes in the *Queensland Petroleum Act 1923.*

The Council understands that measures were taken to ensure that the access arrangements for this pipeline are as consistent as possible with the National Code framework.

In particular, the ACCC, as regulator of transmission pipelines under the National Code, has been advising the Queensland Minister on access principles for this pipeline.

The service provider and the Queensland Government have consulted with the Council on a number of occasions during the development of the access approval process. The Council has indicated that should the ACCC advise the Queensland Minister that the tendering process and access principles are broadly consistent with the National Code, the Council would consider that potential certification issues arising from the derogation have been addressed.

The Council understands that the ACCC has indicated to the Commonwealth and Queensland Ministers that the outcomes of the tender process are reasonably consistent with the principles in the Code, subject to any variation until final approval.

The Council has maintained ongoing consultation with the ACCC on this matter and will seek confirmation of the ACCC's advice to the Queensland Minister once the regulatory process has been completed.

4.4 Assessment issues

I should point out that while the Council's work in access mainly relates to its statutory roles under Part IIIA and the National Code, the Council also regards the effective operation of the National Code as an important *assessment* issue. As I noted earlier, Queensland remains the only mainland jurisdiction yet to make the National Code operational.

Queensland informs the Council that it has chosen to delay making the National Code operational until the Council has concluded its consideration of the effectiveness of the Queensland Regime.

The Council accepts that, given the extensive nature of the derogations and the pending issue of certification, it may be practical for Queensland to await the conclusion of the Council's certification process before making the National Code operational.

The Council will consider whether Queensland has satisfied its obligations with respect to the National Code in the context of a supplementary assessment to be made by 1 July 2000.

5 Reforming regulatory barriers to free and fair trade in gas

The COAG 1994 agreement called on governments to remove all remaining regulatory and legislative barriers to free and fair trade in gas.

A major focus of the legislation review program has been to review upstream issues.

Australian gas markets were traditionally – and to a large extent, still are – characterised by highly integrated supply chains in each State supported by long-term exclusive contracts between producers, pipeliners and retailers. It is difficult to assess the extent to which this structure has impacted on gas prices due to the lack of price transparency in the Australian market. It is frequently argued that well-head prices in Australia are very competitive by international standards. But the same used to be said about electricity prices prior to reform, while gas prices reportedly fell by two-thirds in Canada after upstream gas monopolies in that country were disaggregated.

The Upstream Issues Working Group (UIWG), an intergovernmental group on which the Council was an observer, examined upstream gas reform issues in 1998 and recently finalised a report to COAG on its findings.

The report focussed on three key upstream reform issues:

- barriers to competition arising from acreage management systems;
- third party access to upstream facilities; and
- contractual and marketing arrangements.

5.1 Acreage management issues

In the area of acreage management, the broad issue for the Council is whether the legislative framework – under the various State, Territory and Commonwealth Petroleum Acts – creates conditions for the issue of exploration permits that are conducive to competition. The kinds of issues here include the size and duration of permits, relinquishment and retention arrangements, the allocation criteria used when issuing permits, and publication of exploration data.

The Council accepts that there are issues of balance here. For example, if the size of permits is too small, especially for highly speculative sites, explorers may be reluctant to commit resources to exploration. But the danger of issuing large permits is that dominance may be conferred upon the successful permit holder in the event of a discovery.

The UIWG report to Ministers highlights a number of critical issues in this area, including the need for greater transparency in acreage bidding processes. The Group identified one necessary condition as being to ensure that the details of winning acreage bids are published or made readily available to interested parties.

5.2 Third party access to upstream facilities

Another potential barrier to competition is the monopoly ownership and control of upstream production facilities like gas processing plants and gathering lines. Bottlenecks can arise in the gas supply chain where these facilities are uneconomic to duplicate – that is where there are significant economies of scale and/or scope.

The UIWG identified a need for progress on access to upstream facilities, but was unable to reach agreement on an industry code. However it remains open to individual jurisdictions to introduce legislation providing a basic right for third party access and binding dispute resolution. There are indications that some jurisdictions may adopt this option.

5.3 Marketing issues

The UIWG report found that the present immaturity of Australia's gas markets would make *mandatory* separate marketing by partners in joint ventures premature at this stage. However, the UIWG also found that separate marketing would enhance intra-basin competition, and targeted this as the longer-term goal. In the meantime, it argued that the ACCC should continue to assess the actions of gas joint ventures on the basis of the public interest test, and that the ACCC should be mindful in its ongoing reviews of authorisations of the desirability of requiring separate marketing as soon as this becomes feasible.

5.4 Queensland's Response

Queensland has reported to the Council that, in accord with issues raised by the UIWG, the Government is currently undertaking a targeted public review of the *Petroleum Act 1923*, the *Gas Act 1965* and *Gas Regulations 1989*. The Government recently indicated to the Council that it intends to finalise its position on the reviews in late 1999, with reforms flowing from the reviews expected to be implemented by around June 2000.

Queensland has informed the Council that it intends to update its legislation to ensure that it is consistent with the UIWG recommendations on processes for allocating exploration permits and the award of acreage on an open and competitive basis.

Queensland has also indicated that the review of these Acts will allow for amendments in accord with the licensing and franchising principles in the 1997 Gas Agreement. More generally, Queensland has reported that the COAG principles on open-ended franchises have been observed in the State. Approvals to develop new distribution franchises have been granted on the understanding that they will be subject to full open access provisions upon the introduction of the National Code.

6 Conclusion

The Council's second tranche assessment found that NCP gas reform is progressing satisfactorily in Queensland, notwithstanding the delay in making the Queensland Gas Access Regime operational. At the same time, the ACCC's report on the Queensland derogations will help the Council in assessing whether certification issues arise.

Nationally, the early outcomes of reform have been impressive. An NUS International survey released in January 1999 revealed that Australia is now one of the cheapest gas suppliers to domestic consumers in the world, with only the fully deregulated markets of Canada and the UK delivering lower prices.

At the same time, recent privatisations in Victoria have revealed ongoing buoyancy and confidence in the industry.

But this is no time to rest on the achievements to date. Recent trends indicate that the share of gas in Australia's energy mix has declined since 1995 from 18.2% to 17.7%, probably due to a more competitive electricity sector. Competitive gas access prices and greater competition in the upstream gas sector may be necessary to reverse this trend.

The opportunity for relative growth in natural gas markets has been identified, with ABARE forecasting a potential 28% share of total energy consumption by 2010. Ongoing reform is the key to achieving this goal.