

Pipeline regulatory determinations and elections guide

Explanatory note

September 2023

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1 Introduction

The Australian Energy Regulator (AER) is responsible for determining the regulatory treatment of gas pipelines, through regulatory determinations and classification and reclassification decisions.¹ As part of this role, we are required to publish a Pipeline regulatory determinations and elections guide. The guide outlines how we will approach regulatory determinations, and how stakeholders can make applications relating to the regulatory treatment of a pipeline.

Following consultation on a draft of the Pipeline regulatory determinations and elections guide (the Draft Guide), we published the Pipeline regulatory determinations and elections guide (the Final Guide) on 12 September 2023.²

This explanatory note covers the issues raised by stakeholders in consultation on the Draft Guide, and explains our responses to these issues, and where relevant, how these issues were addressed in the Final Guide.

1.1 Purpose of the Final Guide

The Final Guide sets out:

- the functions and powers of the AER under Part 4 of the National Gas Rules (NGR) and Chapter 3 of the National Gas Law (NGL), including how we will determine:
 - the level of regulation of gas pipelines (form of regulation determinations)
 - the regulation of new pipelines (greenfields determinations).
- the process to be followed by a person when making an application or an election under Part 4 of the NGR for form of regulation determinations and greenfields determinations
- the process the AER will follow when assessing an application under Part 4 of the NGR and Chapter 3 of the NGL³ for form of regulation determinations and greenfields determinations and how we will apply the relevant statutory tests
- the process for making pipeline classification and reclassification applications and decisions (distribution or transmission).

The Final Guide is not binding and does not place obligations on service providers or other parties.

1.2 Consultation process

On 16 June 2023, we published the Draft Guide and invited stakeholders to provide feedback by 26 July 2023.

We received submissions on the Draft Guide from:

¹ See Chapter 3 of the NGL, and Part 4 of the NGR.

² As required under Rule 29H of the NGR.

³ As required under Rule 29H of the NGR.

- Australian Gas Infrastructure Group (AGIG)
- APA
- Public Interest Advocacy Centre (PIAC).

We have considered these submissions in developing the Final Guide.

2 AER response to submissions to the Draft Guide

This chapter outlines the issues raised in submissions to the Draft Guide, and our views on, and responses to, those issues. It also sets out where we have decided to make a change to the Final Guide.

2.1 When the AER should commence a form of regulation determination

APA made submissions about when the AER should commence self-initiated form of regulation reviews, and on the level of evidence that should be required before the AER considers making a form of regulation determination.⁴

First, APA submitted that the ability or incentive to exercise market power, on its own, should not be sufficient to justify commencing an AER-initiated review.⁵ It stated that even though a service provider might be in a monopoly position, there are often constraints on its ability to exercise market power, and that this is reflected in the NGL. APA considered that the wording in the Draft Guide does not reflect this. Specifically, the Draft Guide states:

The AER may consider commencing an AER-initiated review of a non-scheme pipeline where there is evidence to suggest that a service provider may have the ability and incentive to exercise market power, or may be exercising market power, in the supply of pipeline services.

Second, APA submitted on the level of evidence required to commence a form of regulation review.⁶ APA noted that the Draft Guide listed the following as possible reasons for a stakeholder making a form of regulation application:

- an inability to negotiate access to pipeline services
- an inability to negotiate reasonable price terms and conditions
- an inability to negotiate reasonable terms and conditions
- considerations that the service provider is exercising market power in dealings with pipeline users.

APA submitted that there should be ‘firm evidence’ of these types of behaviours by the service provider before the AER considers making a form of regulation determination.

⁴ See [APA, APA Submission: Draft regulatory determinations and elections guide, July 2023](#) (APA Submission), pp 6-7.

⁵ APA Submission, p 6.

⁶ APA Submission, p 7.

2.1.1 AER response

We consider that before commencing a review, there should be evidence to suggest that the service provider may be exercising that market power. To reflect this, we have made the following change to the Final Guide:

*The AER may consider commencing an AER-initiated review of a non-scheme pipeline where there is evidence to suggest that a service provider may have the ability and incentive to exercise market power, **and** may be exercising market power, in the supply of pipeline services.*

In relation to the level of evidence required to make a form of regulation determination, we will consider the strength of evidence both for and against making a regulatory determination, including the strength of evidence of the types of behaviours listed above, in deciding whether or not to make a regulatory determination. This will form part of our consideration of the ‘regulatory determination test’ under s 112 of the NGL.

To make this clear, we have added the following to Section 5.1 of the Final Guide:

In making our assessment under the regulatory determination test, we will also consider the strength of evidence provided on the likely benefits and costs of each form of regulation.

2.2 Relevance of previous decisions

AGIG made a submission regarding prior decisions relating to the form of regulation decisions.⁷ It considered that decisions that applied similar tests to those we would use to determine the form of regulation of pipelines should be explicitly included as a precedent in the Final Guide. In particular, AGIG specified that the National Competition Council (NCC) decisions are a useful precedent due to the form of regulation factors being identical under the old and new versions of the NGL, other than the removal of factor (g)⁸ from the form of regulation factors.

2.2.1 AER response

We agree that previous decisions on the form of regulation applied to a pipeline, using substantially similar form of regulation tests, may be useful in our consideration of whether to make a form of regulation determination. Where relevant, we will consider the NCC approach previously taken. However, we do not consider that we should explicitly refer to the prior decisions as a source of precedent in the Final Guide.

First, while the test that the NCC applied is largely the same as the regulatory determination test we will apply, many aspects of the regulatory framework have changed, meaning that the NCC decisions may not always be useful precedents. In particular, the obligations

⁷ [Australian Gas Infrastructure Group, Draft Pipeline Regulatory Determinations Guide, 26 July 2023](#), p 1.

⁸ Under s 16 of the NGL, there are currently 6 form of regulation factors (i.e. ss 16(a) to (f)). Previously, there was an additional factor under s 16, factor (g), which has now been removed from the NGL. Factor 16(g) was as follows: *the extent to which there is information available to a prospective user or user, and whether that information is adequate, to enable the prospective user or user to negotiate on an informed basis with a service provider for the provision of a pipeline service to them by the service provider.*

applying to full and light regulation pipelines have changed significantly since the NCC applied the test. This means that our assessment of how effective each form of regulation will be in promoting access to pipeline services, and the costs associated with each form of regulation, may differ from the NCC's previous assessment.

Secondly, we note that while we consider that it may often be appropriate to maintain consistency with previous NCC decisions, there is no requirement for us to do so. We therefore do not consider that we should be bound to follow any NCC decision.

Finally, stakeholders, including service providers, will have an opportunity to make submissions on the relevance of NCC decisions during a review, which we will consider.

2.3 Greenfields determinations

The AER may make two types of greenfields determinations. The first is a greenfields incentives determination that effectively exempts a pipeline from regulation for a set period (up to a maximum of 15 years). The second is a greenfields price protection determination that means a set of approved price and non-price terms and conditions for pipeline services are protected in any arbitration of an access dispute involving a service provider. A price protection determination can only be made if a greenfields incentives determination applies to the pipeline.⁹

Section 110 of the NGL sets the test that must be satisfied for the AER to make a greenfields price protection determination, and r 29 of the NGR specifies the matters that must be included in an application for such a determination. There are two tests that can be satisfied for a price protection determination to be granted under s 110, one of which requires that the pipeline was developed following a competitive process. Rule 29 sets out what information about the competitive process must be included in an application for a greenfields price protection determination if a service provider wishes to satisfy this requirement.

APA submitted that the competitive process referred to in r 29 of the NGR does not need to be a competitive process for the development of a pipeline.¹⁰ APA considered that r 29 is technology agnostic and simply refers to a 'competitive process'. It stated that, 'APA frequently participates in competitive processes [which] are technology agnostic and highly competitive. Inter-energy competition, such as competition between natural gas (piped or trucked), diesel, renewables and batteries...' It considers that the test for granting a greenfields incentive determination should capture pipeline projects developed under such broader competitive processes. They considered that such a process would not be captured by the Draft Guide, which only discusses competition for the development of the pipeline.

2.3.1 AER response

We consider that the competitive process the AER must consider when making a greenfields incentives determination or a greenfields price protection determination must be 'competitive for the development of the pipeline'.

⁹ NGL, s 110(1)(a).

¹⁰ APA submission, p 7.

As discussed above, there are two tests that can be satisfied for the AER to make a price protection determination after it has made a greenfields incentives determination under s 110 of the NGL. Relevantly, one requires the AER to be satisfied that the ‘pipeline has been developed following a competitive process.’¹¹

Subsection 110(2) of the NGL makes clear that for the purposes of making a greenfields price protection determination:

*a pipeline is taken to have been developed following a competitive process if the AER is reasonably satisfied from the information provided to it by the applicant for the greenfields price protection determination that there **was competition (whether formal or informal) to develop the pipeline** between 2 or more prospective service providers.*¹²

This clarifies that the intention of subsection 110(1) was that there must be competition for the development of a pipeline.

Further, as noted above, the AER can only make a greenfields price protection determination if it has made a greenfields incentive determination.¹³ When deciding whether to make a greenfields incentive determination, the AER must have regard to (amongst other matters):

*the extent to which the form of regulation factors or **competition to develop the pipeline** (whether formal or informal) between 2 or more unrelated prospective service providers will, or is likely to, pose an effective constraint on the exercise of market power in respect of services provided by means of the pipeline for the period the determination is in operation.*¹⁴

We consider that the relevant competitive process under s 112 is clearly ‘competition to develop the pipeline’.

In conclusion, we consider that section 110 of the NGL is clear and, when read in the context of Chapter 3 of the NGR, the relevant competitive process should be for the development of the pipeline. Therefore, we do not consider there is any need to amend what was stated in the Draft Guide.

2.4 End-user considerations

PIAC’s submission focused on the relevance of outcomes for end-users in form of regulation determinations. PIAC submitted that the Final Guide should focus on likely consumer outcomes instead of theoretical assessments of exercise of market power.¹⁵ PIAC also raised several issues that it considers are relevant to making the decisions on form of regulation reviews:

¹¹ NGL, s 110(1)(b)(i).

¹² NGL, s 110(2).

¹³ NGL, s 110.

¹⁴ NGL, s 112.

¹⁵ [Public Interest Advocacy Centre, Pipeline regulatory determinations and elections guide, 2 August 2023](#) (PIAC submission), p 1.

- In considering whether to commence a self-initiated form of regulation review, the AER should have regard to consumer outcomes instead of assumed benefits or impacts. For example, the assumption that material cost-savings are likely to result from reclassifying existing scheme pipelines simply through a reduction in the ‘cost of regulation’.¹⁶
- The Final Guide should specify the burdens felt by end-users as a result of a determination that will be considered. For example, PIAC considers it should include the risks that consumers assume through a pipeline moving to full regulation and thereby having a guaranteed return for a pipeline in circumstances where the continued operation of the pipeline may be uncertain.¹⁷
- The form of regulation factors (e.g. countervailing market power and substitutes and elasticity of demand) should consider the limitations that end-users face in switching away from a gas service. For example, the Final Guide should note that the elasticity of demand varies across consumer classes, so even if it is technically possible for households to switch from gas, it may not be feasible to do so.¹⁸
- There should be a larger focus on vulnerable and disadvantaged consumers as they are less able to substitute away from gas and costs will be increasingly covered from a smaller pool of users.¹⁹
- Existing distribution pipelines should be fully regulated due to the inability of most consumers to mitigate their costs, choose alternatives, or otherwise discipline market actors.²⁰
- The AER should be cautious against reclassifying existing non-scheme distribution pipelines given such changes stand to shift long-term costs and/or risks onto consumers by potentially inflating the regulated asset base of pipeline service providers.²¹
- The AER should set a high bar for full regulation of transmission pipelines so that gas consumers do not carry the cost and long-term risk of asset stranding.²²
- Transmission pipelines should be lightly regulated due to the greater scope and incentive for retailers and other users to negotiate agreements around transmission pipeline services.²³

2.4.1 AER response

We consider that the Final Guide will make clear that we will consider the types of issues PIAC raised when making an assessment under the regulatory determination test. For example, the Draft Guide states that the AER will consider issues around the substitutability of gas for end-users of services, including where these are vulnerable consumers, when looking at the sixth form of regulation factor (substitutes and elasticity of demand in a market

¹⁶ PIAC submission, p 1.

¹⁷ PIAC submission, p 2.

¹⁸ PIAC submission, p 2.

¹⁹ PIAC submission, p 2.

²⁰ PIAC submission, p 2.

²¹ PIAC submission, p 2.

²² PIAC submission, p 3.

²³ PIAC submission, p 2.

for electricity and gas). From the Draft Guide, it is also clear that we will consider the effect that a determination will have on consumers through having regard to the National Gas Objective.

The purpose of the Final Guide is to explain how the AER will apply the statutory tests. It is not intended to explain all the potential issues that could arise when applying the test, and how these will arise. The issues raised in PIAC's submission may also change over time, be open to debate, and their relevance to a determination may differ depending on the pipeline considered.

The approach we take to assessing form of regulation determinations set out in the Final Guide is meant to be a guide to how we will generally approach our assessment under the NGL, and is not intended to be an exhaustive list of all relevant issues that may arise. We also note in the Final Guide that the relevant matters we consider in making a determination will vary from case to case.

We have therefore decided not to change the Final Guide in response to PIAC's submission. However, the AER will consider these issues, where relevant, when considering whether to make a form of regulation determination.

2.5 Other issues

APA raised two other issues in its submission.

First, APA submitted that the 'threat of greater regulation' of pipelines reduces the attractiveness of investment in gas infrastructure, and makes it more difficult to attract capital to regulated infrastructure. It also submitted that fully regulated pipelines are less likely to be able to rapidly respond to the needs of the market.²⁴

We do not consider that this requires an amendment to the Final Guide. The purpose of the Final Guide is to set out how we will approach conducting our role under the NGL, and does not change the likelihood of a non-scheme (or lightly regulated) pipeline becoming fully regulated. Therefore, we do not consider that a change needs to be made to the Final Guide to address the impact that the 'threat of greater regulation' may have on investment in pipelines. Further, we note that in considering whether to make a form of regulation determination that would lead to a lightly regulated pipeline becoming fully regulated, we must have regard to the National Gas Objective. The National Gas Objective is:

*to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.*²⁵

Therefore, in considering whether to make a determination that a pipeline should become a scheme pipeline that is fully regulated, we will take into account how the decision may impact efficient investment in the pipeline.

²⁴ APA submission, pp 5-6.

²⁵ NGL, s 23.

Secondly, APA submitted that we should engage with regulated businesses before conducting AER-initiated form of regulation reviews.²⁶ Generally, we will discuss a proposal to conduct a form of regulation review with a service provider before doing so. We have therefore made the following amendment to the Final Guide to make this clear:

In general, we will inform the relevant service provider that we are considering conducting a self-initiated form of regulation review before we commence the review.

2.6 Correction of error

A change was made to the Final Guide to correct an error on page 16 of the Draft Guide. Stakeholders were made aware of the error on 7 July 2023. The corrected paragraph is as follows (with changes in bold):

*If we decide not to make a determination, **once constructed**, the pipeline will **be** a non-scheme pipeline.¹⁰ **However, it could become a scheme pipeline in the future if a scheme pipeline determination or scheme pipeline election was made.***

²⁶ APA submission, p 4.